ASSOCIATION OF ACA CONSULTING ACTUARIES

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11 May 2016

Louise Sivyer
The Pensions Regulator
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Dear Louise

DC guides in support of new DC Code of Practice

I am writing on behalf of the Association of Consulting Actuaries (ACA) in response to the consultation on the six guides in support of the DC Code.

Our comments on the specific questions you raised are set out in the Appendix to this letter along with some general observations and some drafting points. We would note that our overall sense is that the guides are excellent and extremely helpful.

We hope that you find our comments of assistance and would be happy to discuss them further if that is helpful. Please contact me at Hugh_Nolan@spenceandpartners.co.uk or on 0207 495 4619 if you require further assistance.

Yours sincerely

Hugh Nolan

Hugh Nolan
Chairman
ACA DC Committee

Sent by e-mail to: DCconsultation@tpr.gov.uk

RESPONSE FROM THE ASSOCIATION OF CONSULTING ACTUARIES (ACA) TO CONSULTATION ON SIX GUIDES IN SUPPORT OF DC CODE

Question 1: In relation to the Administration guide and the processing of transfers
Would the speed of completing a transfer of money purchase benefits be improved if we set a recommended timescale, from the point of a member's initial request, within which a transfer should be completed?
Would setting a timescale of this nature effectively address the delays that the government identified in its consultation on Pension Transfers and Early Exit Charges? If so, what timescale do you think should be set?
If you do not think that setting a timescale would be effective, please explain why?

We do not believe that setting a recommended timescale would necessarily improve the speed of completion of transfers of money purchase benefits, except potentially where the benefits to be transferred are simple. Complexities arise regarding, for example:

- Where benefits under a scheme are invested across multiple legacy AVC arrangements
- Where there are Defined Benefit underpins – such as GMPs, Reference Scheme Test benefits and scheme-specific underpins
- Where transfers are in respect of partial benefits – and the need to ensure appropriate handling within trustee policies, correct interaction with other benefits (such as death benefits) and correct alignment with a scheme's Trust Deed and Rules.

We note that the consultation on Pension Transfers and Early Exit Charges highlighted the difference in average transfer times for contract-based and trust-based arrangements. We would suggest that the differences in average times arise largely due to the additional complexities of scheme designs within trust-based arrangements, compared with contract-based arrangements.

As stated in the draft Administration Guide, "there is a balance to be struck in relation to the processing of transfers, between prompt processing and adequate due diligence". We believe this is not only to guard against the risk of pension scams (which is itself an important priority), but also to guard against the risk of errors and the resulting time and expense to fix errors. It is of course important that schemes should not be complacent and simply excuse overly slow processing by claiming due diligence.

We believe a better approach would be to focus on providing members with simple and effective explanations of the transfer process, such as a user-friendly process flow highlighting where member input is needed. The Regulator could provide such an example, based on a simple money purchase arrangement (with high-level timeframes for different stages), which schemes could then adapt for their specific approach.

Question 2: In relation to all of the guides
Do you have any examples that you think could be usefully included to demonstrate the different approaches that schemes of different sizes, and with varying available resources, might take to comply with any of the standards we have set in the new code? If so, please provide further details.

Overall, we believe the Guides all quote useful examples and are very helpful in setting out a good standard in each area and we would expect that individual schemes could readily adapt these examples to fit their own circumstances.

To illustrate this point, the question of how often trustee boards should meet provokes strong reactions, despite a general agreement that quarterly meetings are largely appropriate. There is some concern that boards meeting less frequently are unable to react quickly but this can be addressed by sub-committees or decisions made by correspondence between meetings. Small schemes with few members and little urgent business to discuss may reasonably meet less frequently but large schemes or those undergoing change may need to meet even more often.

Although we therefore believe that it would be inappropriate to make the Guides too prescriptive or to cover every possible situation, we do have some suggestions for additions to the existing Guides. We are aware that the combined Guides do seem very substantial as reading material for trustees but they are well written and relatively easy to read, especially if tackled one at a time. We therefore believe there is some scope for adding further examples without overburdening scheme managers.

For the Administration Guide, we note the vital importance of accurate life-styling in ensuring members receive their correct outcomes. It might therefore be helpful to illustrate the extent to which schemes rely on automated systems, scheme-wide reasonableness checks and sample spot-checks as part of the annual audit. In particular, it is important to ensure that the life-styling matrix used by the administrators has been approved by the investment advisers and is kept up to date after any changes.

There are several examples that could be added to the *Investment Governance Guide*, as follows:

- The level of delegation used – typically, smaller schemes with constrained time and budgets have made greater use of delegation, whether to a bundled provider (with an “off the shelf” default option), an investment manager (eg use of target date funds) or to a fiduciary manager. This reduces the need for, and the cost of, some of the design and manager selection process. In these instances, clear roles and responsibilities and the ongoing monitoring of the delegated entity might be the prime focus of investment governance.
- Unbundled schemes will typically have a greater need to use an investment platform, to limit multiple contracts with different fund managers (and the operational burden and cost for the administrator). Such a platform requires additional specific governance but can often simplify scheme transactions, reporting and governance overall.
- Trustees typically consider investment governance of AVCs proportionately. However, the quality and timeliness of information available from legacy AVC providers can often be poor and the options available to trustees to make changes are limited, making AVC governance frustrating. We believe that further practical support for trustees here would be helpful.
- Where resources are limited trustees might reasonably seek to use tools, template communication materials and training content from bundled scheme providers and fund managers. Whilst trustees recognise this will not be bespoke to their circumstances and should be reviewed carefully before use, such resources can be very helpful.

The Communications Guide sets out various considerations for trustees of schemes of various sizes. The example of how small schemes may be able to give members access to technology is particularly helpful, given the current trend for online access.

There is a useful example on page 11 of the VFM Guide about smaller schemes focussing on online research. We believe that further examples for smaller schemes would be helpful, both here and generally. However, we recognise that the Guides are not intended to be exhaustive and acknowledge the need to balance the insight from further examples against unnecessary length of the Guides, which may demotivate potential readers.

Finally, we note that the Guides clearly state that a proportionate approach should be taken where DC funds under management are not deemed to be material. However, we believe this point could be highlighted even more, perhaps simply by using different formatting, to reassure diligent trustees who are already making reasonable and appropriate efforts. Similarly, the VFM Guide specifies the key point that the Guide only relates to costs met by members and again it would be helpful if this disclaimer could be highlighted by different formatting to make it even more obvious. This would make the VFM Guide much less daunting for smaller schemes in particular.

Question 3: In relation to all of the guides
Are there any topics relevant to the standards we have set in the new code on which you believe we have not provided sufficient detail within the guides? If so, please provide details.

Again, we believe that the Guides generally provide a very helpful level of detail. There is some feeling in the pension industry that illustrative examples could accidentally become an informal standard (much like the triggers for recovery periods in DB schemes). This does mean that some users would prefer absolute clarity at a very detailed level, though we appreciate that this is not your intention and we endorse your positioning of the Guides. Nevertheless, we would like to take this opportunity to make some detailed comments as set out below.

Many of the suggested steps and processes may be viewed as very involved/complex and are impractical for smaller schemes with limited time and resources, who will therefore need to adopt a proportionate approach. Some specific examples are highlighted below:

- The *Appointing new Trustees* section in Guide 1 envisages a formal recruitment process for trustees including references, sight of certificates and various directorship, disqualification/bankruptcy and even criminal record checks. It would help to have a proportionate example in the guidance – e.g. where trustees are current employees of the sponsor, it might be reasonable just to confirm the employer has carried out such checks.
- Having a professional trustee is to be welcomed but small schemes may struggle to do this in practice. It might be useful to include some guidance on how best to select a professional trustee.
- In the *Appointing new Trustees and Board Composition* sections, it can be difficult for smaller schemes to recruit trustees (especially MNTs) and so a selection process with competence-based interviews and psychometric testing is unrealistic and there may need to be a compromise over finding a perfect knowledge, skills and societal demographic match. An example acknowledging this type of situation would be helpful.

- It seems eminently sensible for a trustee board to assess the required range of skills before appointing new trustees needed so that the selection doesn't leave any accidental gaps in coverage. The reference to this "work back" scenario in the Guide could usefully be strengthened.
- The *Guide 1 Board meetings* section states that in most cases trustees will meet "at least quarterly" and may have ad hoc additional meetings. Our experience is varied but it is not uncommon for trustees of smaller schemes to meet formally less frequently than quarterly (say twice yearly) in the context of the trustees being in regular contact by e-mail or telephone, receiving governance reports such as investment reports more regularly and being able to collectively make urgent decisions outside of a formal meeting. The guidance could helpfully be expanded to acknowledge such situations by way of an example.
- Any Sub-Committees should have a detailed Terms of Reference agreed, documented and regularly reviewed and this should be made clear in the Guides.
- We believe the role of the Secretariat is vital and should ideally be separate from the trustee board, though we recognise that will not always be practical. We would welcome further guidance on the role and skills needed for the Secretariat.
- The *Guide 2 Introduction* suggests that training plans should support the development and improvement of skills and then lists relevant skills. These are not areas where advisers are likely to provide training, nor would employers necessarily have the resource to provide such training internally. It is likely such training would need to be sourced externally at a cost and small organisations in particular may have constrained budgets. An example acknowledging what reasonable steps would be in a constrained situation might be helpful.
- We very much welcome the suggestion of mentoring and succession planning.
- *Guide 2 Working well with advisers, providers and employers* refers to a process to set selection criteria, researching the reputation of providers, asking for recommendations and considering multiple providers as part of a tender process. This is course makes sense when selecting key advisers e.g. actuaries, legal advisers and investment advisers but smaller schemes selecting an AVC provider might sensibly keep costs down by seeking a single recommendation from their trusted investment adviser. An example covering this kind of circumstance might be helpful.
- The *Guide 2 Working well with advisers, providers and employers* section promotes trustees having a "constructive relationship" with the employer and suggests all the ways trustees might benefit from the employer's assistance. Sadly, not all trustee/employer relationships are collaborative which may be due to lack of employer's understanding, lack of time or unwillingness/inability to pay fees to cover governance costs and an example suggesting the steps trustees should take in such circumstances may be helpful.

We also have the following suggestions for the *Administration Guide*:

a) DC asset transitions – this is partly covered in the Investment Guide (understanding the different transition approaches) and we believe it would be valuable to include examples here too, given the administrative issues are critical to successful transitions but are often little understood.

    - It would also help to ensure that consideration of "core financial transactions" is not restricted to the regular monthly contribution/investment cycle and individual changes/payments.
    - Asset transitions may involve blackout periods, potentially impacting member retirements or transfers etc if not appropriately communicated and planned

b) Provide examples of member satisfaction surveys to help schemes with limited resources.

- We believe optimal surveys are brief (eg no more than 10 questions, no longer than 5 minutes to complete), signposting at the start how many questions there are and how long it should take.

c) The Guide categorises Administration Manuals as "best practice", so smaller schemes may not bother to have one – despite the key man risk that many such schemes face from being highly reliant on a single individual. Categorising up-to-date process/administration manuals as "good practice" and providing more examples to show the importance for small schemes and for those with legacy complexities might therefore be useful.

We consider that the *Investment Guide* could also usefully include:

- In considering the merits of establishing an investment sub-committee, trustees may also wish to consider their ability/past experience of making timely and effective decisions.
- Further information on appropriate benchmarks (both short term and long term), in particular the need to see beyond traditional index-based market benchmarks in order to focus on member experience and outcomes.
- Guidance/information that investment 'risk' can be multi-dimensional and may change over time. For example, traditionally trustees have viewed long dated bonds as 'low risk' in the context of a default investment strategy glide-path, and communicated this to members. Members might then be surprised at capital falls in rising yield environments. Whilst still 'lower risk' in connection with matching annuity purchase, being heavily invested in pooled bond funds would nowadays represent higher risk for those planning to take funds as cash or enter income drawdown. Elements of this issue are usefully covered in the guide (page 12) and could be extended/referenced elsewhere to encompass risk definitions.

Similarly, we believe the *Communicating and Reporting Guide* could also include:

- Trustees produce an annual Trustee Report and Accounts but there is very little reference to this in the Guide. It may be helpful to link how the various items under reporting (annual Chair's statement and SIP) are relevant to the Report and Accounts.
- On page 7, we agree that the key messages for communicating with members are doing so at the right time and in the right format. Another key aspect is ensuring members have the right support, ie pointing members to where they can get further help where needed and limiting the number of communications sent so that members are not overloaded.

We like the detail provided in the VFM Guide about transaction costs but believe this could be further enhanced by putting this into perspective (e.g. are the transaction costs not only reasonable as a nominal amount but also for the value achieved from earning extra returns or reducing risks). We also feel something similar to the transaction costs section would be useful for investment management fees, which are typically some of the larger costs.

Question 4: In relation to accountability for regulator impact

Do you agree with our draft business engagement assessment on the impact of the new DC code on business that we have published alongside this document? If not, please provide details.

If, having reviewed the new code in light of the draft guides, you believe the standards set out in the code are likely to significantly increase or reduce costs to any parties involved in running a scheme offering money purchase benefits, please quantify the relevant costs or benefits in the Excel template published alongside this document. Significant costs or benefits should be calculated relative to the existing DC code, and over and above costs that might be incurred as a result of complying with the underlying legislation.

Broadly – yes. We believe that the revised DC Code does not result in significant changes in costs, over and above costs already incurred to comply with the current legislation, regulation and Code. Where additional costs could be incurred, this should be as a result of a scheme deciding to meet "best practice" as opposed to compliance and/or good practice levels.

The guides suggest that a proportionate approach is taken and so we would agree with the draft business engagement assessment published. We are aware of some concern that the guides may nevertheless be interpreted as mandatory by some people, especially given the lack of total clarity on precisely what proportionality means (e.g. for schemes with few members with DC/AVC funds even if one member's funds are material to him individually). On balance, we believe that the guides allow a "common sense" approach and that it is impossible in practice to illustrate every scenario.

We believe the guides provide very helpful information for scheme managers. In any event, if some schemes incur additional costs unnecessarily by slavishly following specific examples of best practice, scheme members will generally benefit from the higher standard of governance even though it was not strictly required.

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11 May 2016