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Alistair Elliott
DC, governance and administration
The Pensions Regulator
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Dear Alistair

Consultation on Regulating Work-based Defined Contribution Pension Schemes

We are writing with our response to your consultation document on the above.

Members of the Association of Consulting Actuaries provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members advise schemes covering the majority of members of private sector defined benefit and defined contribution schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

We fully support the general principles that the DC code and DC regulatory guidance are aiming to achieve and we set out in the Appendix our responses to your questions. However, we would like to highlight a couple of key points:

- The Pensions Regulator might want to consider whether including AVCs for DB schemes within the scope of the DC code and DC regulatory guidance is proportionate. An option to consider would be a requirement for trustees of DB schemes with AVCs to actively encourage the transfer of AVCs to another DC arrangement, instead of undertaking to comply with the provisions of the Code and Guidance in respect of the AVCs. We set out further comments in our response to Question 11.

- Both the DC code and the DC regulatory guidance are very detailed. We feel that a shorter and more concise DC code, supported by further detail in the DC regulatory guidance, would be more user-friendly. Currently it is intuitively hard to appreciate the distinction between the DC code and DC regulatory guidance.

- The DC regulatory approach sets out concerns that the Regulator holds over "small to medium sized" schemes. We consider trust-based schemes of this size are better placed to provide their members with a scheme that is appropriate for the membership than many contract based or master trust arrangements.

  For example, the design of the investment default that is appropriate for an employer with a highly financially aware workforce will differ from the appropriate default for an employer employing mainly manual workers. A small trust based scheme can be tailored to reflect these characteristics whereas a contract based scheme or master trust is more likely to have an "off the shelf" approach.

  We therefore believe that small to medium sized schemes should be supported and encouraged to improve governance standards rather than phased out.

  The document also states, "*We do not expect to see existing .. schemes that fall within this segment [less than 1,000 members] being used for auto-enrolment*". This will be news that is not palatable to employers who do have schemes in this segment who are doing their best to comply with auto-enrolment. On top of forcing them to comply with auto-enrolment processes and have a scheme which must already meet stringent minimum benefit requirements laid out under Pensions Act 2008, Guidance that they should not use the scheme they have operated to date introduces another layer of complexity prior to staging date.

  If the Guidance is to be clear on this point then we suggest you defer the implementation to something like, "*Over time, we would not expect to see such schemes to continue to be used for automatic enrolment unless value for money can be demonstrated.*" Most of these employers have staging dates which start from October 2013. They do not have time to put in place a new scheme to replace their existing one, nor is there appetite amongst providers for this business, at such short notice.

We hope you find this response helpful. If you wish to follow up any points, please contact me on paul.macro@mercer.com

Yours sincerely

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Appendix: Specific consultation questions

DC regulatory approach and DC quality features

Q1 – One of the quality features requires that "*A default strategy is provided which is suitable for the needs of members*". We suggest that more general wording should be used as it is not possible to provide a default strategy that is suitable for all members' needs. For example, it may be more achievable to require that "*A default strategy is provided which is suitable for the needs of* ***the*** *member****ship***".

Q2 – We have no specific comment on this question.

Q3 – It is not clear to whom the voluntary disclosure of compliance with the DC code and DC regulatory guidance is expected to be made and it is consequently difficult to envisage the form that this might take.

Q4 – Yes

Q5 – No. Pensions legislation is already sufficiently complicated and a well-policed Code of Practice should be able to raise governance standards without the need to resort to legislation.

DC Code

Q6 – Refer to our comments on question 17 which refer to this.

Q7 – Yes. Although we think there is a lot of duplication between the existing TKU guidance and the existing internal controls guidance and perhaps there could be more cross referencing rather than what seems to be duplication.

Q8 – No

Q9 – No

Section 1: Introduction

Q10 – Yes

Q11 – In general we agree that high standards should be expected of all schemes that provide members with DC benefits. However we believe a proportionate approach is appropriate, in particular for DB schemes that provide an AVC facility for their members.

DB scheme trustees are already subject to regulatory standards on, for example, internal controls and trustee knowledge and understanding. It is disproportionate to expect them to devote a significant amount of time on DC-specific requirements for AVCs, which usually represent a very small part of the overall scheme.

AVCs will almost always also be a small part of a member's retirement benefits and will in many cases be taken entirely as a lump sum. By definition the benefits will be in addition to the member's DB pension.

We agree that value for money, good investment returns, appropriate investments and good governance are as important for AVCs as any other DC benefit. However, there are some aspects of the Code and Guidance which are not appropriate for AVCs, for example:

- it does not seem necessary to write regularly to members to remind them of the importance of making contributions as by definition AVCs are a top up to a DB pension
- the level of detail on purchasing annuities that it will be appropriate to provide to a member who is looking to secure their future retirement income from their DC pension pot will simply be a further layer of complexity for members looking to retire from their DB scheme and take their AVC benefits as a lump sum in lieu of commuting their DB pension.

In addition, few employers are expected to use DB schemes to meet automatic enrolment requirements for the bulk of their employees. Most will therefore have a DC arrangement of some form that will fall under either the Pension Regulator's DC Code of Practice or the FSA's rules.

The Pensions Regulator may wish to consider whether compliance with the DC Code and Guidance is disproportionate in respect of such benefits. An option to consider instead of undertaking to comply with the provisions of the Code and Guidance may be to require trustees of DB schemes with AVCs to actively encourage the transfer of AVCs to another DC arrangement.

This should mean that member's interests are protected as they will have the option of placing their DC benefits in a scheme that fully complies with the Regulator's (or FSA's) standards, but will not cause a further regulatory burden on DB schemes.

Section 2: Know your scheme

Q12 – Paragraph 43 of the draft Code of Practice suggests that trustees should check members' terms of employment for consistency with scheme benefits. We question whether trustees will have access to members' terms of employment. Instead the Code could suggest that trustees request the employer to confirm that the scheme benefits are consistent with the terms of employment.

Section 3: Risk management

Q13 – Yes

Q14 – A notifiable events regime could help the Regulator monitor standards in DC schemes. If such a regime were to be introduced we would suggest that notifiable events are limited to errors that cause a loss to members above a de minimis amount. The limit could vary depending on the proportion of the scheme members affected.

Section 4: Investment

Q15 – We have no specific comment on this question.

Section 5: Governance of conflicts of interest and advisers / service providers

Q16 – Yes

Section 6: Administration

Q17 – Yes

However, we note that in this section paragraph 201 is repeated at paragraph 204 which does not seem necessary given their proximity.

Also, a section of paragraph 169 is repeated in paragraph 213. Given the length of the Code of Practice we consider it will be more user-friendly if it is condensed as far as possible.

DC guidance

Q18 – Paragraph 35 sets out that "*A scheme offers value for money where the costs and charges deducted from members' pots or contributions are competitive in relation to the benefits and services provided to members, when compared to other options available in the market.*"

The first bullet point under paragraph 53 then suggests that trustees should be reviewing investment performance as part of their value for money assessment, which is not consistent with the concept of value for money as outlined above.

We fully support that trustees should be encouraged to keep investment performance under regular review. However we believe this should be kept separate from the assessment of value for money for two reasons:

- It will otherwise be impossible to comply with the quality feature that requires that "*All members receive value for money*". Poor investment returns is a risk inherent in the nature of DC schemes that even the best-run schemes cannot eliminate.
- It is not consistent with the assessment of value for money in proportion to the benefits or services provided.

Paragraph 38 states that , "*Where trustees conclude that a scheme or service provider is not delivering value for money, they should take action. Trustees should act as demanding consumers on behalf of their members, challenging their service providers to provide better services or reduce costs where they are not delivering value for money.*" We think that there are two issues with this statement:

- The first is that there is no clear guidance on what is value for money and how it is to be measured. Trustees will not have the time or resources to undertake market surveys or provider reviews just to assess competitiveness of charges, if this is how they are to be measured.
- The second issue is that whilst we agree that trustees should demand and get value for money, the language used suggests rather aggressive behaviour by trustees - "demanding", "challenging".

Q19 – The final bullet point under paragraph 54 suggests that for any consultancy charges "*there should be demonstrable value to the members who are paying this charge*" but there is no practical guidance on how this might be achieved.

Q20 – Yes

Q21 – Yes, but greater emphasis could be given to information being accessible the members as and when they need it (for example, charges disclosed on a website) with only absolutely key information being posted to members. Too much information being disclosed directly to the member is likely to aid neither engagement nor understanding.

Impact assessment statement

Q22 – In theory the DC Code and DC regulatory guidance do not introduce many new principles that are not already present in law or other non-DC-specific codes and guidance.

However, in practice a scheme may comply with all the key principles and still have to spend considerable additional resources to demonstrate compliance, particularly in view of the level of detail in the code and guidance.

The level of the additional costs involved will be dependent on how the Regulator intends trustees to report compliance and how it will monitor compliance. A further consideration will be how quickly the Regulator will expect schemes to bring themselves up to standard.

Q23 – We have no specific comment on this question.

Q24 – No.

Response by:

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