	Opinion	
Impact Assessment (IA)	Minimum governance standards for defined contribution trust-based schemes	
Lead Department/Agency	Department for Work and Pensions	
Stage	Final	
IA number	DWP0045	
Origin	Domestic	
Expected date of implementation	6 April 2015 (SNR 9)	
Date submitted to RPC	16 September 2014	
RPC Opinion date and reference	9 October 2014	RPC14-DWP-2032(3)
Departmental Assessment		
One-in, Two-out status	IN	
Estimate of the Equivalent Annual Net Cost to Business (EANCB)	£5.05 million	
RPC Overall Assessment	GREEN	
<p>RPC comments</p> <p>The IA is fit for purpose. The Department proposes to improve governance of the market for defined contribution (DC) trust-based pension schemes by introducing a set of statutory minimum governance standards.</p> <p>The Department has addressed the issues raised in the Committee’s previous opinion of 3 September 2014. Specifically, the IA now provides additional evidence from stakeholders, allowing the Department to monetise the costs associated with the requirements of the new regulations more fully. The RPC is satisfied that the estimated Equivalent Annual Net Cost to Business (EANCB) has been correctly assessed as £5.05 million. This is higher than the Department’s original estimate of £3.79 million each year, because the Department has now monetised more of the costs to employers.</p>		
<p>Background (extracts from IA)</p> <p>What is the problem under consideration? Why is government intervention necessary?</p> <p><i>“Automatic enrolment will generate an extra £11 billion a year in pension savings from around six to nine million people newly saving, or saving more, into a pension. In most cases people will be automatically enrolled into a defined contribution (DC) pension scheme. These schemes must deliver the best possible value for money and good retirement outcomes for scheme members. The 2013 Office of Fair Trading (OFT) DC market study found that competition alone cannot be relied upon to drive value for money in the DC workplace pension market due to weaknesses in the buyer side of the market and the complexity of the product.</i>”</p>		

Government intervention is necessary to ensure all individuals saving into a workplace pension get value for money, protecting members from consumer detriment. In the absence of minimum governance standards set out in legislation the risk of a market investigation by the Competition and Markets Authority would be likely to create uncertainty, disruption, costs and reputational damage to the pensions industry. This impact assessment focuses on minimum governance standards for DC trust-based schemes only. Minimum governance standards in DC contract-based schemes are considered separately by the Financial Conduct Authority in their consultation paper 'Proposed rules for independent governance committees' published in August 2014."

What are the policy objectives and the intended effects?

"The policy objective is to ensure that all individuals saving into DC workplace pensions get value for money. The OFT concluded that good quality, independent scheme governance can help to mitigate the impact of the weak buyer side of the market by ensuring on-going scrutiny of value for money on behalf of scheme members. They found that governance of many schemes across the market is currently not sufficiently strong to provide this scrutiny. Introducing minimum governance standards for DC trust-based schemes, (considered in this IA) and contract-based schemes (covered separately by the FCA) will address this weakness in the market, to help to maintain trust in automatic enrolment and private pension saving and improve retirement outcomes for scheme members."

Comments on the robustness of the OITO assessment

The IA says that the proposals for DC trust-based schemes are regulatory measures that would impose a net cost on business (an 'IN'). The estimated EANCB is £5.05 million. This assessment is consistent with the current Better Regulation Framework Manual (paragraph 1.9.10) and, based on the evidence presented, appears to provide a reasonable assessment of the likely impacts. The additional evidence provided by the Department is sufficiently robust to justify validation.

The IA now explains clearly how the minimum standards in contract-based schemes fall within the remit of the FCA to take forward. These costs are therefore out of scope of OITO (paragraphs 6 to 11).

Comments on the robustness of the Small & Micro Business Assessment (SaMBA)

The proposals increase the scope of regulation on business. A SaMBA is, therefore, required. The SaMBA is adequate.

The Department does not propose to exempt small and micro pension schemes, with the exception of small self-administered schemes. In such self-administered schemes, the members are also the trustees who are administering the pension savings on their own behalfs. As such, incentives are aligned and they are acting in their own best interest.

In the case of other small and micro pension schemes, the SaMBA explains that

92% of trust-based schemes are classified as small and micro pension schemes. However, these schemes represent only 100,000 (or 4%) of the 2.7 million individuals saving into such trust-based schemes (paragraph 80). While it would appear that exempting small and micro-businesses would not have an impact on a large proportion of the market, the IA states that the OFT's market study expressed concern about the risk of member detriment in small trust-based schemes, due to poor governance.

Currently non-compliance with the minimum standards is more likely amongst small and micro schemes. For example 24% of small schemes are unaware of the Pensions Regulator's publication on the "*six principles for good workplace DC*", compared with 10% of large schemes, The Department argues that "*this adds to the case that intervention for small schemes is required*" (paragraph 101).

Quality of the analysis and evidence presented in the IA

The Department proposes to improve the governance of DC trust-based pension schemes by introducing a set of statutory minimum governance standards. The IA addresses the issues raised in the Committee's opinion of 3 September 2014, and now includes other monetised impacts. Specifically, the IA now provides (i) a more robust explanation of how often schemes will review their default strategies; and (ii) evidence relating to the recruitment process undertaken by the Mastertrusts schemes.

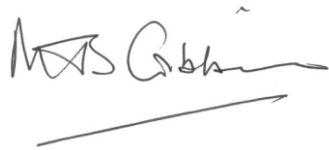
The impact on business will be the costs associated with meeting and maintaining the standards. The Department has retained the assumption used at consultation stage that, across all DC trust-based schemes, around half of the costs would be borne by the employer and half by the scheme member. Therefore, it is assumed that business will bear half of all costs.

The key proposed standards and associated quantified costs are as follows:

- The 'chair's statement' (on-going costs to business of £4.3 million) – all schemes will face costs in producing a statement attached to the annual report and audited accounts that explains how they have complied with the minimum governance standards. The Pensions Regulator has estimated that the additional cost of producing this statement would be between £350 and £3,250 per scheme each year, depending on the size of the scheme.
- Default strategies (one-off costs to business of £1.55 million) – such strategies must be designed in the interests of members, with a clear statement of aims, objectives and structure and how these are appropriate for members. The characteristics and net performance of the funds underlying the default strategy must be regularly reviewed to ensure alignment with the interests of members. There is evidence from the regulator and from industry experts that only a minority of schemes may need to undertake some demographic analysis of their membership profile. The Department estimates that 4,600 schemes will need to undertake a demographic analysis of their scheme.

- Reviewing the default strategy and the performance of the underlying funds (on-going costs of £4.25 million every three years) – the Department estimates that around half (8,500) of DC trust-based schemes would need to review their default strategy in accordance with the new requirements. Industry experts have advised that the cost of reviewing each default strategy is around £1,000. The Department expects pension providers will review their default strategy once every three years.
- Minimum of three trustees, of which two must be independent of the scheme (£0.7 million each year in salaries and £0.2 million every five years in recruitment costs) - Mastertrusts will need to meet some additional requirements, which may require some Mastertrusts to recruit new members. Desk-based research indicates that 85% (50) of Mastertrusts schemes will need to appoint a second trustee who is independent. This will result in recruitment costs and additional on-going salary costs. The minimum standard will require Mastertrusts to use an open and transparent recruitment process to recruit new trustees who are independent. Depending on the number of trustees in these schemes, some will also need to appoint a third trustee.

The RPC considers this to be a reasonable assessment of the impacts of the proposal.



Michael Gibbons, Chairman