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Our ref: ICAEW Rep 45/10

Your ref:

Glenn Fallows  
Investment Governance Group Secretariat  
c/o The Pensions Regulator  
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Brighton  
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Dear Glenn

## **INVESTMENT GOVERNANCE OF DEFINED CONTRIBUTION (DC) PENSION SCHEMES**

The ICAEW is pleased to respond to your request for comments on *Investment governance of defined contribution (DC) pension schemes*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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## ICAEW REPRESENTATION

### INVESTMENT GOVERNANCE OF DEFINED CONTRIBUTION (DC) PENSION SCHEMES

**Memorandum of comment submitted in June by the ICAEW, in response to Investment Governance Group consultation paper Investment governance of defined contribution (DC) pension schemes published in March 2010**

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## INTRODUCTION

1. The ICAEW welcomes the opportunity to comment on the consultation paper *Investment governance of defined contribution (DC) pension schemes* published by the Investment Governance Group (IGG).

## WHO WE ARE

2. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

## MAJOR POINTS

4. We are very supportive of this initiative by the Investment Governance Group to develop “best practice” guidance in today’s DC pension environment and would be pleased to contribute and assist where we can. If the accountancy, business and audit background of our members would be of use to the Group in formulating further guidance we would be pleased to join any working party or join discussions on a more informal basis.
5. We are generally supportive of the principles and best practice guidance set out in this IGG Consultation paper, but would raise three major points. Firstly, we agree with the statement on page 9 of the guidance which states “*it is important to stress that whilst employers remain accountable in the investment governance process, they are able to delegate their investment governance decisions and processes to third parties*”. However, the Table of accountabilities on page 12 implies that “responsibility” can also be delegated. We consider that the guidance should be clear on this point and remove any ambiguity, preferably by clarifying that employers should retain and not delegate their overall responsibility for contract based schemes.
6. The second point is with regard to governance over operational matters, which are not really mentioned in the guidance. We consider this to be a shortcoming, and a practical way in which it could be dealt with might be by cross-referring to the Pensions Regulator’s guidance on internal controls and risk management.
7. The third area is that the guidance does not mention consideration of the level of pension that is likely to be delivered. Whilst we appreciate that the level of contributions is a matter for benefit design and primarily an employer consideration, we do consider that those charged with governance should consider the level of pension likely to be delivered as this can and should have a bearing on both investment strategy and communications.

## RESPONSES TO SPECIFIC QUESTIONS

1a) How accurate is the *Table of accountabilities* and *Principle 1* in defining the roles and responsibilities of decision-makers? and

1b) Do the *Table* and *Principle 1* make it clear that employers and trustees are accountable, but can delegate their responsibility to third parties, eg through clear terms of engagement with providers? and

1c) How practical is it for employers and trustees to carry out their roles and responsibilities where required or to delegate them?

8. As referred to above, we consider the guidance does not make it clear enough whether it is “responsibility” or the implementation of decisions which can be delegated. Our view is that ultimate responsibility should be retained by the decision maker. We concur, however that clear terms of engagement with providers are highly desirable.

1d) To what extent will the documentation (eg in a governance plan or similar document) of roles and of any conflicts of interest assist in dealing with conflict issues?

9. We consider that a governance plan or similar document will be helpful in clarifying roles and identifying any conflicts of interest and how these are to be managed so long as it is not a boiler plate document supplied by advisers or providers. We consider the greatest benefit of such documents is that they can provide a framework for those responsible for governance properly to consider these matters.

2a) What recommendations do readers have for addressing gaps in the knowledge and understanding of employers, their delegates and trustees of small schemes needing to follow this guidance?

10. It would be particularly useful if on-line toolkits were developed by the Investment Governance Group or the Pensions Regulator to help improve the knowledge and understanding of those involved with small schemes in particular

2b) How can decision-makers best be helped to assess their own performance as decision-makers as well as the investment performance of their fund managers?

11. Decision makers could ask for feedback on their performance from their advisers. Investment advisers should be asked to comment on the performance of fund managers, alternatively fund managers could be asked to explain their performance compared to published data such as benchmark data.

3. Do the ‘*Best practice*’ guidance points listed in *Principle 3* comprehensively cover the processes necessary to ensure that scheme members are offered appropriate investment options:

a) at the outset

b) in the run-up to and at retirement

12. Generally Principle 3 covers the key considerations however it states that “*decision makers should....offer an appropriate default strategy*”. Not all trust-based and contract-based schemes currently offer a default strategy as there is a belief amongst some that members should make investment decisions and members should be provided with access to advice to enable them to do so. Is the guidance saying that such an approach is not appropriate and that all schemes should offer a default fund?

13. For contract-based schemes employers do not have to consider the post retirement arrangements after someone has left employment, whereas trust-based schemes members

would remain part of the trust as deferred members and this distinction needs to be made in the guidance.

4a) Does the guidance provide appropriate parameters for setting a default strategy? b) To what extent, if any, might this guidance limit the possibilities for innovation in respect of default strategies?

14. We consider that the guidance does provide appropriate parameters and should not limit the possibilities for innovation as departures will be able to be “explained” or “justified”.

5a) The process of performance assessment is an essential component of best practice in investment governance decision-making. To what extent does the guidance given in *Principle 5* ensure that this process is in itself effective?

15. Generally the guidance on performance assessment seems to be appropriate.

6a) To what extent does the content and level of communications allow members to make an informed choice about funds in which to invest?

6b) The ‘*Best practice*’ guidance here requires decision-makers to provide members with information in the run-up to and at retirement. Is it right to do this, and if so, has it been given sufficient emphasis? Is there a need for further guidance on this point?

16. No comment.

7a) To what extent will the proposed approach (comprising *Principles*, ‘*Best practice*’ guidance and a *Table of accountabilities*):

- improve standards of investment decision-making and governance in the workplace DC environment and/or in your case?

- help align decision-making in the best interests of the pension fund member?

17. The guidance will help to increase the focus on defined contribution investment governance for both trust-based and contract-based schemes and this is welcomed. For some schemes this will result in little change, but for some schemes where less attention has been paid to governance this may result in changes such as the establishment of a default fund and more attention being given to the range of funds and communication with members.

18. At the moment very little attention is given to contract-based schemes by many employers and it is hoped that this guidance will align the investment governance arrangements for contract-based and trust-based schemes.

7b) As the *Principles* and *Guidance* are presented as “best practice”, do you think we should encourage decision-makers by saying “comply or explain”, “justify or comply” or would you like to suggest an alternative wording?

19. Our preference is for “justify or comply”.

7c) Do the *Principles* cover all the key issues? Please indicate any areas you do not agree with and reasons.

20. See our general comments above.

8a) To what extent will you use the *Principles*? If not, why not?

21. N/A

8b) Do you currently use any existing guidance? How does it help your processes/practice?

22. N/A

8c) Will the *Principles* and *Table* work for both contract-based and trust-based defined contribution schemes?

23. Yes, we believe they will.

8d) Are there any *Principles* or points in the '*Best practice*' guidance where further guidance may be useful to you? See Annex B for list of relevant existing guidance.

24. As referred to earlier, further guidance in respect of operational controls would be useful.

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