

**Pensions Client
Directorate**

**Pensions - Consultation on Draft
Guidance**

**The use of Default Options in
Workplace Personal Pensions
and the use of Group Self
Invested Personal Pensions for
Automatic Enrolment.**

24 September 2009

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Part One - Foreword and consultation arrangements

Who this consultation is aimed at

- 1 This consultation is aimed at all employers, employee representatives and all pension industry professionals, including occupational pension and workplace personal pension scheme administrators, payroll administrators, accountants, payroll bureaux, Independent Financial Advisors and employee benefit consultants. Comments from workers and the general public are also welcome.

Subject of consultation

- 2 This document sits alongside the three consultations on the proposed regulations to be made in exercise of powers contained in the Pensions Act 2008. This consultation concerns:
 - the use of default options in workplace personal pensions¹ used for automatic enrolment; and
 - the use of group self invested personal pensions (SIPPs) for automatic enrolment.
- 3 It is proposed that compliance with this guidance would be monitored from the commencement of the employer duty, currently scheduled for 2012.

Purpose of the consultation

- 4 This document seeks views on the following:
 - the design of default options in workplace personal pensions used for automatic enrolment, how they are offered, governance arrangements and communicating the default option, including ongoing communications; and
 - the definition of SIPPs and group SIPPs and how they should be structured and offered when used for automatic enrolment.

Scope of consultation

- 5 This consultation applies to England, Wales and Scotland. Northern Ireland will be covered by parallel legislation which will be identical to the final regulations.

Duration of the consultation

- 6 The consultation period begins on 24 September and runs until 17 December.

¹ 'Workplace personal pensions' is an umbrella term covering group personal pensions, group self invested personal pensions and stakeholder pensions.

How can you respond to this consultation?

7 This document is available on the Department's website at:
www.dwp.gov.uk/consultations.

8 Please send your response, preferably by e-mail to:

workplace-pension.reform-consultation@dwp.gsi.gov.uk

Or by post to:

**Elizabeth Wenzerul
Department for Work and Pensions
Enabling Retirement Savings Programme
7th Floor
Caxton House
Tothill Street
London
SW1H 9NA**

Please ensure your response reaches us by 17 December.

9 When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of a larger organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled. We will acknowledge your response.

Queries about the content of this document

10 Any queries about the subject matter of this consultation should be made to Elizabeth Wenzerul at the above address, or telephone 0207 449 7548.

11 We have sent this consultation document to a large number of people and organisations who have already been involved in this work or who have expressed an interest. Please do share this document with, or tell us about, anyone you think will want to be involved in this consultation.

Freedom of information

12 The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

13 All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purpose of the public consultation exercise, it is

understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information which is provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this. We cannot guarantee confidentiality of electronic responses even if your IT system claims it automatically.

- 14 If you want to find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact:

**Central Freedom of Information Team
Department for Work and Pensions,
The Adelphi
1-11 John Adam Street,
London WC2N 6HT
Email: freedom-of-information-request@dwp.gsi.gov.uk**

- 15 More information about the Freedom of Information Act can be found on the website of the Ministry of Justice FOI pages.

The consultation criteria

- 16 This consultation follows the Code of Practice on Consultation - www.berr.gov.uk/files/file47158.pdf. and its seven consultation criteria which are as follows:

- **When to Consult** - Formal consultation should take place at a stage when there is scope to influence the outcome.
- **Duration of consultation exercises** - Consultations should normally last for at least 12 weeks, with consideration given to longer timescales where feasible and sensible.
- **Clarity of scope and impact** - Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence, and the expected costs and benefits of the proposals.
- **Accessibility of consultation exercises** - Consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is designed to reach.
- **The burden of consultation** - Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
- **Responsiveness of consultation exercises** - Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
- **Capacity to consult** - Officials running consultation exercises should seek guidance in how to run an effective consultation exercise, and share what they have learned from the experience.

Feedback on this consultation

17 We value your feedback on how well we consult. If you have any comments on the process of this consultation (as opposed to the issues raised) please contact our Consultation Coordinator:

Name: Roger Pugh
Address: Department for Work and Pensions' Consultation
Coordinator: Room 2A, Britannia House,
2, Ferensway, Hull HU2 8NF
Phone: 01482 609571
Fax: 01482 609658
Email: roger.pugh@dwp.gsi.gov.uk

In particular, please tell us if you feel that the consultation does not satisfy these criteria. Please also make any suggestions as to how the process of consultation could be improved further.

18 If you have any requirements that we need to meet to enable you to comment, please let us know.

19 The responses to the consultation will be published in 2010 in a report on the DWP website that will summarise the responses and the action that we will take as a result of them.

Part Two – Default options in workplace personal pensions used for automatic enrolment

Guidance for the operators of workplace personal pensions on designing a default option for their automatic enrolment schemes

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1: The Pensions Act 2008 and automatic enrolment

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- 1.2 Aims of this guidance

2: Default options - An ongoing process

- 2.1 Designing a default option
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- 2.3 Governance of the default option
- 2.4 Communicating the default option
- 2.5 Ongoing communications

Chapter 1: The Pensions Act 2008 and automatic enrolment

1. The Pensions Act 2008 introduces a duty on employers to automatically enrol all eligible jobholders into qualifying workplace pension provision from 2012.
2. Eligible jobholders are those aged between 22 and state pension age, who are working or ordinarily working in Great Britain and are earning more than £5,035 a year (in 2006/07 earnings terms).
3. Employers are able to choose the qualifying workplace pension scheme they adopt to discharge this duty.
4. A qualifying scheme is a scheme which meets specific criteria as laid out in the Pensions Act 2008, and could be:
 - an occupational scheme, including the personal accounts scheme; or
 - a workplace personal pension scheme, which could be a Group Personal Pension (GPP), a Stakeholder Pension (SHP), or a Self-Invested Personal Pension (SIPP).
5. Workplace personal pensions must, in order to be a qualifying scheme, be registered under Chapter 2 of Part 4 of the Finance Act, and must meet the quality requirements for defined contribution (DC) personal pension schemes. The quality requirements are:
 - all benefits provided to the jobholder under the scheme must be money purchase benefits;
 - the employer must pay contributions equal to or more than 3 per cent of the amount of the jobholder's qualifying earnings in the relevant pay reference period;
 - the jobholder must pay the shortfall between the employer's contribution and 8 per cent of the jobholder's qualifying earnings in the relevant pay reference period; and
 - there must be direct payment arrangements between the jobholder and the employer.
6. In order to be used for the purposes of automatic enrolment, a scheme must be a qualifying scheme² and must, in addition, satisfy the conditions laid out at section 17 of the Pensions Act 2008, which are that:
 - no provision of the scheme prevents the employer from making arrangements for the jobholder to become an active member of the scheme; and
 - no provision of the scheme requires the jobholder to express a choice in relation to any matter, or to provide any information in order to remain an active member.

² Qualifying criteria are contained in the Pensions Act 2008 and the Consultation Document 'Workplace Pensions Reform: Completing the Picture' currently being consulted on.

1.1 Automatic enrolment and the 'default option'

7. Given that individuals cannot be required to make an active choice when being automatically enrolled qualifying schemes used for automatic enrolment have to have a default option in place.
8. The default option is the investment option used when an individual pension member does not indicate an investment choice.
9. It is likely that the vast majority of individuals being automatically enrolled under the employer duty will not make an active choice with regard to which fund they are enrolled into. These individuals will therefore be enrolled into a default option.
10. This means that default options will play a vital role in the post-2012 world.

1.2 Aims of this guidance

11. The Department for Work and Pensions is issuing this guidance to ensure minimum standards across default options used in workplace personal pensions.
12. It is aimed at the operators of qualifying workplace pension schemes and sets out some high-level principles which we believe operators should follow when designing the default options for their automatic enrolment schemes. By operator we mean the person who is, for the purposes of regulation, the operator of the pension scheme with the relevant FSA permission (Regulated Activities Order article 52³).

Q1 – Consultation question: Does the use of 'operator' provide enough clarity on who falls under the remit of this guidance?

13. A key aim of this guidance is therefore to clarify where the responsibility lies in the design of default options in workplace personal pensions.
14. This guidance has been developed with the support of the Financial Services Authority (FSA) and should be read in conjunction with their Treating Customers Fairly principles. It has also been designed to align with the guidance which is currently being developed by the Investment Governance Group⁴ on best practice in all DC schemes, which will include a principle relating to default options.

³ <http://www.opsi.gov.uk/si/si2006/20061969.htm>

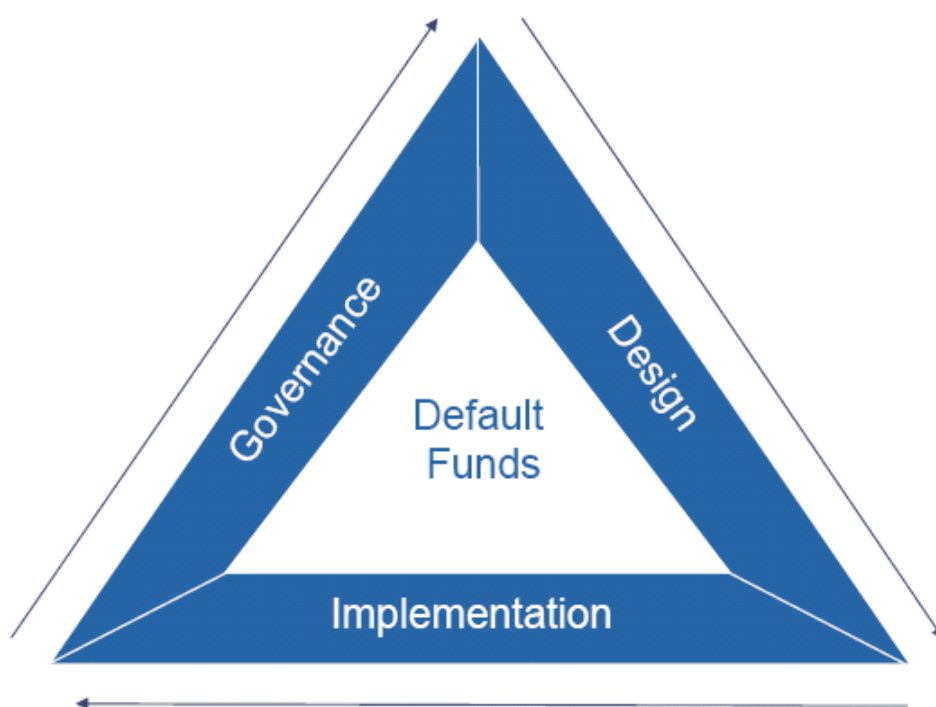
⁴ The group, established following a National Association of Pension Funds review and Government consultation into the Myners principles, will implement an industry-led framework for the application of the principles.
<http://www.thepensionsregulator.gov.uk/igg/index.aspx>

15. This guidance relates to workplace personal pensions only, because of the different way in which occupational schemes work.

Q2 – Consultation question: Do you think the Department should issue separate guidance on the design of default options in occupational schemes as well?

16. This use of this guidance will be monitored by the DWP and regulatory steps taken at a later date if necessary.

Chapter Two: Default options - An ongoing process



17. The above diagram depicts what we believe is an ongoing process of designing default funds

- **Design**
- **Implementation**
- **Governance**

18. **Communication** also plays a vital role at all stages of this process.

19. Where a workplace personal pension is being used as a qualifying scheme for automatic enrolment the ongoing responsibility for the design, implementation, governance and communication of the default option lies with the **operator**. Whilst we realise that intermediaries and

employers have their role to play in the design of the default option the underlying responsibility still rests with the operator.

2.1 Designing a default option

20. When designing a default option, operators should follow the principles **set out below** in several key areas :

Objective

- The default option should have a high-level objective, which explains in broad terms what the default option aims to do and the strategy it will use in order to achieve this aim.

Suitability

- Operators should liaise as necessary with the employer they are producing the default option for and any intermediary to make sure that the default option is, on reasonable grounds, likely to be suitable for the majority of the members, in terms of its investment strategy and asset allocation.

Affordability

- The default option should be appropriately and competitively priced. Total charges should be below the stakeholder price cap.

De-risking mechanism

- The default option should have in place a form of de-risking mechanism. By de-risking we mean a strategy which mitigates members' investment volatility appropriately over the lifetime of the product, for example, traditional lifestyling or DC banking.

- This de-risking should form part of the overall objective of the default option.

- The de-risking strategy should take into account the retirement profile of members.

Asset allocation

- The default option should invest in a diversified portfolio of assets. Whilst suitable diversification will be a matter for the operator it would not be appropriate for the default option to invest solely in the shares of one company or a single specialized area.

- Shares of the company of the employer using the scheme should not make up more than 5 per cent of the default option.

2.2 Offering/implementing a default option

21. When offering default options to employers, we would recommend the following:

- operators should present the employer with a **manageable** and **targeted** set of options; and
- each of the options presented to an employer should have a high-level objective and meet the principles set out above.

Q3 – Would it be helpful to set out in guidance how many options we feel should be offered to the employer? If so, we would welcome views on what is a manageable number of options.

22. The aim of offering default options in this way is to facilitate the decision-making process of the employer/intermediary.

2.3 Governance of the default option

23. Responsibility for the overall governance of the default option lies with the operator.

24. The default option should be reviewed by operators on a regular basis and when certain events occur, e.g.

- when there are changes in the fund management personnel involved in running the default strategy;
- when there are changes in the ownership of the fund managers; or
- when there is consistent underperformance of the underlying funds used in the strategy against common industry benchmarks.

Q4 – Consultation question: Would it be useful to define ‘common industry benchmarks’ more closely?

Q5- Consultation question: Are there any other cases which should trigger a review?

25. The review of the default option should look at:

- the ongoing suitability of the default option for members;
- the ongoing suitability of the charge level;
- the performance of individual fund components; and
- whether the performance of individual components is consistent with the overall objective of the default option.

26. We also recommend that operators should remind employers to review the default strategy they have selected on a regular basis to check its ongoing suitability for their workforce.

Q6- Consultation question: What else should the review of the default option look at?

2.4 Communicating the default option

Initial communications

27. The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 specify what information must be provided to members as part of the terms and conditions of a personal pension contract, and an operator should make sure that, when providing this information, it is communicated in a clear manner.
28. The FSA's Conduct of Business Rules also prescribes what information must be disclosed at the point of sale for contract based schemes.
29. We would suggest that initial communications to members regarding the default option should include the following:
- a description of the default option and the rationale behind it;
 - a statement of the overall objective of the default option;
 - an explanation of how the objective is going to be achieved, including an explanation of what funds have been chosen and for what reason;
 - an explanation of the management strategy and the aims of that strategy; and
 - an explanation of the de-risking mechanism and what it aims to achieve. This is especially important given that as the member nears retirement they may realise that de-risking may not be suitable for them if, for example, they are retiring early or late or are taking income drawdown.
30. All of these aspects of the default option should be communicated in a **clear manner** which the member can easily understand.

2.5 Ongoing communications

31. On an ongoing basis, we would recommend that communications include the following:

- operators should communicate to members that they will review the default on a regular basis and make information on the review available to members on request; and

- as a member is nearing retirement, operators should communicate the rationale behind the de-risking strategy and reconfirm with the member their expected retirement date.

Q7 - Consultation question: We are considering recommending that operators should make information on the review of their default option available on their website. How feasible is this?

Part Three - Automatic enrolment into Self Invested Personal Pensions (SIPPs)

Guidance on the use of Group SIPPs when used for automatic enrolment

Contents

1. Introduction

- 1.1 Aims of this guidance
- 1.2 Background
- 1.3 Qualifying schemes
- 1.4 Automatic enrolment schemes

2. What is a SIPP/Group SIPP?

3. Using a Group SIPP for the purposes of automatic enrolment

Chapter 1: Introduction

1.1 Aims of this guidance

1. This guidance has been issued by the Department for Work and Pensions and has been developed with the support of the Financial Services Authority (FSA) and the Pensions Regulator (TPR).
2. It sets out good practice for the use of Group SIPPs for automatic enrolment under the provisions of the Pensions Act 2008.
3. This guidance is not legally binding, but is intended to set out:
 - for **operators**, how they should operate a Group SIPP if it is being offered as an automatic enrolment scheme;
 - for **employers**, how a Group SIPP should be structured if they are selecting it as the automatic enrolment vehicle for their workforce.
4. This use of this guidance will be monitored by the DWP and regulatory steps taken at a later date if necessary.

1.2 Background

5. The Pensions Act 2008 sets out a series of measures aimed at encouraging wider participation in private pension saving. The aim of these reforms is to overcome the decision-making inertia that currently characterises individuals' attitudes to pension saving and to make it easier for individuals to save for their retirement.
6. The measures in the Act include a duty on employers to automatically enrol all eligible jobholders into qualifying workplace pension provision from 2012.
7. Eligible jobholders are those aged between 22 and state pension age, who are working or ordinarily working in Great Britain and are earning more than £5,035 a year (in 2006/07 earnings terms).
8. Employers are able to choose the qualifying workplace pension scheme they adopt to discharge this duty.
9. A qualifying scheme is a scheme which meets specific criteria as laid out in the Pensions Act 2008, and could be:
 - an occupational pension scheme, including the personal accounts scheme;
 - a Group Personal Pension (GPP);
 - a Group Stakeholder Pension (SHP); or
 - a Group Self-Invested Personal Pension (SIPP).

1.3 Qualifying schemes

10. To be a qualifying scheme, a UK personal pension scheme must be registered under Chapter 2 of Part 4 of the Finance Act 2004 and must meet the quality requirements for defined contribution personal pension schemes. The quality requirements are:
- all benefits provided to the jobholder under the scheme must be money purchase benefits;
 - the employer must pay contributions equal to or more than 3 per cent of the amount of the jobholder's qualifying earnings in the relevant pay reference period;
 - the jobholder must pay the shortfall between the employer's contribution and 8 per cent of the jobholder's qualifying earnings in the relevant pay reference period; and
 - there must be direct payment arrangements between the jobholder and the employer.

1.4 Automatic enrolment schemes

11. To be used for the purposes of automatic enrolment, a scheme must be a qualifying scheme and must, in addition, satisfy the conditions laid out at section 17 of the Pensions Act 2008 which are that:
- no provision of the scheme prevents the employer from making arrangements for the jobholder to become an active member of the scheme; and
 - no provision of the scheme requires the jobholder to express a choice in relation to any matter, or to provide any information, in order to remain an active member.

Chapter 2: What is a SIPP/Group SIPP?

12. A **Self Invested Personal Pension (SIPP)** is an arrangement which forms all or part of a personal pension scheme, which gives the member the power to direct **specifically** how some or all of the member's contributions are invested (as opposed to simply choosing a fund or funds).
13. A **Group Self Invested Personal Pension (Group SIPP)** is a group personal pension where the contracts are SIPPs rather than personal pensions. So a GSIPP is a SIPP which is available to employees of the same employer or of employers within a group.
14. The GSIPP market usually operates by GSIPPs being offered by employers to their employees and usually allows members to opt either for a simple personal pension style product or for a full range of SIPP investment options. Typically charges will reflect the investments available to members.

Q1 – Are these definitions helpful and are there any alternative definitions which you could suggest?

15. The operation of a personal pension, which includes SIPPs, is a regulated activity. Therefore anyone operating a Group SIPP must be authorised by the FSA. SIPP operators include insurance companies and specialist fund management groups.

Chapter 3: Using a Group SIPP for automatic enrolment

16. Individuals cannot be required to make an active choice during the process of being automatically enrolled into a pension scheme by their employer.
17. This makes it vitally important that the product into which they are being automatically enrolled is appropriate.
18. In order to be used for automatic enrolment, a Group SIPP must meet the requirements laid out in the Pensions Act 2008 (see paragraphs 9 and 10) and be used in the following manner.
19. Jobholders should **only** be automatically enrolled into the default fund of a Group SIPP. This default fund should:
 - resemble that of a group personal pension;
 - be priced at levels comparable to those found in a typical group personal pension; and
 - comply with the guidance on what the government views as good practice when designating a default fund, which currently forms the other part of this consultation document.
20. It should not automatically offer individuals a self-investment option at automatic enrolment.
21. Once automatically enrolled into the default fund, members can choose to invest in other retail pooled funds if they wish to. These funds should have comparable charging levels to those found in a typical group personal pension.
22. The overall effect of charges on the member from the SIPP policy should ensure that members are not paying for features which they do not need and/or will not use.
23. Beyond these pooled funds, the member could choose to access the self-investment option and its full range of investments by agreeing terms and conditions with the scheme operator under which s/he can access these investments.
24. Individuals should be informed at this stage of all the charges which apply to operating self-investment and they should also be encouraged

to take financial advice as this type of investment is generally more complicated.

25. These jobholders will have made the active choice to invest in a far greater range of assets than the default fund and the pooled funds give access to.

Q2 – Would it be helpful to provide separate sections on the use of insured and non-insured group SIPPs given their different structures?

Q3 – Do you view non-insured group SIPPs as a suitable product for auto-enrolment, given their non-tiered structure?

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