Sackers

DC briefing

March 2015

Highlighting the latest developments in DC for trustees and employers

Welcome

DC schemes should offer members "value for money". That's easy to say and difficult to disagree with, but from April this year schemes will also have a legal requirement to measure it. This shines the spotlight on balancing good investment returns and the cost of getting these as never before. And it's not to be confused with the charges cap on default funds. Just because you've kept your charges down doesn't mean you are necessarily providing good value.

We are focusing on investment related issues in this briefing. Where before we have had best practice and guidance, from April there will be legal duties too. Many schemes will find they can meet these by adapting the information they are already receiving to monitor their investments, but it is also a useful opportunity to think afresh about what you really need to measure to check funds are delivering what you expected them to.

There is a way to go before we all start feeling comfortable we know what is required in the brave new DC world, but in the run-up to April:

- don't panic
- do check you know what your default funds are
- do bring your default fund charges in line with the 0.75% charge cap (there really isn't much wriggle room here)
- do make sure you are ready to explain to members what options they do and don't have from the scheme.

The rest is a work in progress for everyone.

Four key DC issues

Investment review – new requirement

From this April, the trustees of DC schemes will be required to prepare and review a statement of the investment principles governing the default fund. Trustees will also have to explain how the default strategy ensures that assets are invested in the best interests of members and beneficiaries.

In order to discharge their duties, trustees will need to be prepared to undertake fund reviews at regular intervals. This will enable them to benchmark their objectives against the performance of the fund and to determine if the objectives are being met. In doing this, trustees will need to make sure that the funds take account of the membership's needs, from both a legal and an investment perspective.

TPR's DC Code (which remains in place) expects trustees' investment reviews to address the security of funds and of any investment platform. This involves legal and financial due diligence because trustees need to understand the operation of the funds and platform, and the degree to which the members' assets are protected. In doing this work, trustees will need to take into account such things as creditworthiness of the providers and the counterparty risk associated with them.

Four key DC issues cont.

Keep your governance committees!

If you are an employer with a contract-based DC pension scheme, the chances are that you will have set up a governance committee to help run and manage it.

With providers of contract-based pension schemes required to establish independent governance committees (IGCs), employers may be considering disbanding their arrangements. If matters are being dealt with 'higher up', why would an individual employer devote its own management time and resources to governance of the pension scheme?

However, having already established a governance committee, it could be a false economy to withdraw it. There are at least three good practical reasons to keep the committee in place:

- Monitoring suitability – the IGC will not consider whether the scheme remains suitable for each individual employer.
- Managing the provider relationship – individual employers will still need to monitor day-to-day standards of administration, communications and charges.
- Forum for member involvement – a governance committee is a useful forum for gathering details of member experience, allowing engagement between the employer and its employees regarding the pension scheme on offer.

If you need further persuasion, the FCA itself "sees no reason why [governance committees] should not work alongside IGCs".

How might a "second line of defence" impact on DC flexibilities in occupational schemes?

Initially, we were told that trustees would only be required to signpost the guidance guarantee (now called "Pension Wise") in their member communications and provide information to members to help them make an informed decision. However, the government has recently upped the ante. Following an FCA "Dear CEO" letter to personal pension providers explaining it intends to put in place a "second line of defence" for consumers, the government confirmed that it is working with TPR on extending this to trust-based schemes too.

The FCA requirements are yet to be fleshed out into rules, but look set to require pension providers to ask those seeking to access their DC pension savings about key aspects of their circumstances relating to the choice that they are making, and give relevant risk warnings in response to the answers. They will also need to describe the tax implications where a customer plans to take cash from their pension pot. The government has not yet explained how it sees this working in a trust-based environment.

Schemes considering whether to offer the new flexibilities available from April should keep in mind that, whatever options are offered, the scheme must be satisfied it can clearly explain them and their likely consequences.

One size fits all?

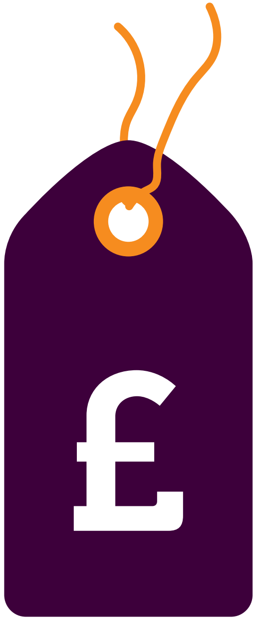
Are the days of the single default fund numbered? Traditionally trustees would select a single fund as the default and the assets of all members would automatically be invested in this single fund unless a member chose a different option. However, times are changing. From April, members will no longer be restricted to taking just cash or a pension at retirement, and there will be new legal requirements for schemes to manage and report on the aims and objectives of the default. Is it possible for one default fund to meet all a scheme's needs?

Increasingly, schemes are considering moving from one to a number of default funds. This is sometimes referred to as "segmentation", and it relies on taking a more active approach to default funds. Trustees review and select different default funds for different segments of DC members based on the characteristics of those particular DC members and looking at reasons why members are likely to want to invest in certain investments over others (eg are they able to take much investment risk? are they likely to want to drawdown their benefits?).

If trustees want to do this, they need to make sure that they are not inadvertently tripped up by the basis and assumptions they use when selecting a DC default fund for a particular category of members. For instance, there may be claims of discrimination if insufficient thought is given to why age triggers might be set for moving investments, and trustees need to be careful in second guessing the financial circumstances of particular members based on employment records alone. Also, the new charges cap will apply to all a scheme's default funds and this may make a wide selection of default funds difficult for trustees to manage.

In the short-term at least, the most important thing is to communicate the pros and cons of different funds rather than expect to be able to find a perfect solution to every member's investment needs straight away.

Spotlight: what constitutes "value for money"?



Why do you need to know?

From this April, trustees have a new legal duty to carry out an annual assessment of whether a DC scheme's charges and transaction costs represent "good value" for members. The term "value for money" ("VfM") does not appear in the legislation, but it's the shorthand we have all adopted. So is VfM like an elephant? Describing each of its features on their own could give us a very distorted picture, and we need to learn to stand back and look at the whole "animal". TPR's guidance on VfM in the DC Code and Guidance gives schemes a good starting point for doing this.

What is value for money?

There is no statutory definition. According to TPR, it is where the costs of membership provide good value in relation to the benefits of membership, compared with other options available in the market; it "does not necessarily mean low cost, provided higher costs can be justified by improved benefits".

The analysis splits into two elements.

- Objective – costs and charges of the scheme
- Subjective – scheme benefits, service levels, communication methods and governance.

TPR adds an additional layer of subjectivity requiring trustees to understand which components of the scheme its members value most.

Approaching a value for money assessment?

Starting a VfM assessment can seem overwhelming. The net for information gathering is cast wide and there are many moving parts. There are also obvious difficulties in accessing information about other market options eg there is no firm timeframe of implementation for rules on transparency of costs and charges.

However, the lack of prescription could be positive. Trustees are being encouraged to undertake a scheme specific assessment rather than fit their scheme into a strait jacket designed by the government (contrast the 0.75% default fund charge cap).

Considerations when putting together an assessment process include:

1. What information is available for the scheme and other schemes?

2. Should the trustees be asking for further information eg from advisers (such as a further breakdown of costs) or the employer (regarding benefit design or communication options)?

3. What exercises will be undertaken to survey member values (eg talking to them, other communications, assumptions based on accurate and up-to-date membership profiling)?

4. What form will the analysis take (eg will values be assigned to each scheme feature)?

Well governed schemes will find that these considerations are not new. It will most likely be an exercise in using the information in a different way or simply adding an extra layer to controls already in place.

Finally, it is worth bearing in mind that TPR has said that it will revise its DC Code and Guidance in 2015. We are at the start of what feels like a long journey on this, and schemes shouldn't necessarily expect to arrive at their ideal destination first time around.

Sackers

Contact

Sackers is the leading law firm for pension scheme trustees and employers. Over fifty lawyers focus on pensions and its related areas, including our DC experts who provide practical and specialist help on all aspects of DC schemes. For more information on any of the articles in this briefing, please get in touch with Helen Ball, Faith Dickson or your usual Sackers contact.

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Upcoming seminars & events

We offer an extensive programme of workshops, seminars and trustee training. If you would like to attend any of these events, please contact our marketing team at marketing@sackers.com or visit www.sackers.com.

Event	Date	Details
New DC flexibilities – what they will mean in practice	19/03/2015	Breakfast seminar (9.00am – 10.30am) This session will look at some of the key issues facing trustees and employers when the new flexibilities for DC pension savers and their survivors come into force on 6 April 2015.
Professional Pensions Law in Practice	26/03/2015	Helen Ball, head of DC at Sackers, speaks on DC governance at this all day conference in London. The conference will provide vital insights on key legal issues of practical importance in the post-Budget regime.
Quarterly Legal Update	14/05/2015	Breakfast seminar (9.00am – 10.30am) The latest legal and regulatory developments in the pensions world, with a special DC update from Helen Ball.

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