

DC hot topic

February 2016

Asset security

Following the introduction of automatic enrolment and an increasing regulatory focus on DC governance, DC asset security is now in the spotlight. However, not all trustees feel comfortable that they understand the risks and mitigations associated with their DC arrangements.

Why do trustees need to know?

TPR's DC Code requires trustees to give "due consideration to [DC] asset protection and understand what would happen in the event of a problem". As part of their review, it suggested that trustees consider counterparty risks, the creditworthiness of the DC provider and the extent to which a loss of assets might be covered by a compensation scheme or indemnity insurance.

TPR recently consulted on a revised DC Code, expected to come into force in July 2016. The current draft of the revised DC Code would require trustees to assess how any loss of scheme assets might be covered by a compensation scheme and "to communicate the overall conclusion about the security of assets to members and employers".

What are the key risks – platform provider structure?

Provider default

This is the risk associated with the platform provider's covenant. An understanding of the provider's financial reserves and confirmation from the provider of how they meet the PRA's minimum requirements can bring trustees some comfort. Trustees should also understand the level of FSCS cover that may be available if the provider were to suffer an insolvency event.

"Cross-contamination"

This is the risk that the platform provider writes risk-related business (such as annuities or life assurance), which could affect the provider's ability to fulfil its obligations under the contract with the trustees. Trustees should understand what business the platform provider writes and what measures it has in place to mitigate the cross-contamination risk. There is also an equivalent risk associated with the underlying funds that should be thought through.

Third party default

As trustees do not have a direct contractual relationship with third party fund managers, there is a risk associated with the platform provider's recourse to assets. Trustees should understand any protections available to aid the provider's recourse. For example, any insulation against third party default resulting from the structure of the fund, or any floating charges granted over the fund's assets where accessed through reinsurance arrangements.

Asset security cont.

What if trustees don't use a platform?

Matters are slightly more straightforward where trustees hold DC investments directly. However, it remains just as important to understand the risks around potential default of the fund provider or manager and the legal structures used. Trustees should also understand how their investment could be impacted by other funds offered by the same provider and in what circumstances "cross-contamination" could result in the fund or its manager being unable to meet their obligations. Not all direct investments will be the same or have the same risks.

What should trustees be doing?



Key questions for trustees

- Do I understand how the scheme's DC arrangements are structured, both at platform provider level and the underlying funds that sit on the platform?
- What are the key risks associated with each of those structures?
- What protections or mitigating features are present for each risk?



What approach should I follow?

As TPR recognises, this is a complex area. DC investment structures can be multifaceted, involving a number of counterparties. Assessments of asset security within these structures can be carried out with varying degrees of granularity.

The key approach is one of due diligence. Asking the right questions of providers and advisers and understanding the answers.

It is also not a one-off exercise. As the business of providers and managers changes, so does the degree of risk associated with corresponding investments.



Where can I look for guidance?

In February 2016 the Security of DC Assets Working Party launched the first guide for trustees to help them explore the levels of protection in place for DC assets.

A copy of the guide can be found on the AMNT website at:

<http://amnt.org/policy-and-research/dc-assets/>

For more information, please get in touch with [Anna Copestake](#) who is a member of the Security of Assets Working Party, [Jacqui Reid](#), [Oliver Topping](#) or your usual Sackers' contact.