

DC briefing

March 2016

Highlighting the latest developments in DC for trustees, employers and providers



All hands on deck

Pension schemes are used to dealing with change and the last 12 months have been no exception. We are now waiting to hear whether the Chancellor has yet more in store when he delivers the 2016 Budget on 16 March (now known as “T-Day”) and announces the outcome of the Government’s consultation on pensions tax relief. Much of the pensions press seems to be focusing on a move to flat rate relief but, at this stage, nothing can be ruled out. Despite the myriad of rumours, we may yet find ourselves in a system of “taxed – exempt – exempt”.

Even without further changes, sponsors and trustees of DC pension schemes have plenty to keep themselves busy. This spring the first set of DC annual governance statements will fall due, while this summer should see TPR’s new DC Code come into force. Trustees must ensure they are well prepared and understand what is expected of them. For many schemes this will mean undertaking additional, and perhaps more formal, trustee training and ensuring advisers are well briefed on what information will be needed and when.

So, it is all hands on deck for the year ahead, whatever it may bring!

Four key DC issues

DC asset security

DC asset security is in the spotlight. TPR’s DC Code requires trustees to give “due consideration to asset protection and understand what would happen in the event of a problem” and the revised version looks set to retain this focus.

The key risks are:

- provider or manager default – how strong is the manager or provider’s covenant, what are the risks associated with the legal structure used and what level of Financial Services Compensation Scheme cover would be available in the event of insolvency?
- “cross-contamination” – how could scheme investments be impacted by funds offered or business written by the same provider and in what circumstances would the provider, fund or fund manager be unable to fulfil its obligations to the trustees?
- third party default – with platform structures trustees do not have a direct contractual relationship with third party fund

managers, so they should understand what recourse the provider has to assets.

These issues are relevant to both direct investments and investments made through a platform.

Trustees should understand how their scheme’s DC arrangements are structured, what risks are associated with those structures and how those risks can be mitigated.

This is a complex area. DC investment structures can be multifaceted and assessments of asset security can be carried out with varying degrees of granularity. Trustees should be asking the right questions of the right people and understanding the answers.

As the business of providers and managers changes so does the degree of risk associated with corresponding investments. Trustees should keep a watching brief.

Four key DC issues cont.

DC investment: employer duties

Employers have a key role to play in setting and reviewing the investment options in their DC pension arrangements.

The precise nature of their role depends on the type of arrangement in question.

On set-up, employers will be typically involved in reviewing a statement of investment principles (trust-based scheme), agreeing benefit schedules with providers (master trust), or negotiating contracts governing the operation of individual or group personal pension policies.

It is a scheme's trustees who have a statutory responsibility to review the default arrangement and assess whether all the investment options offer value for money in terms of member-borne charges. Similarly, providers are heavily regulated by the FCA and governance of their pension products has, since April

2015, been scrutinised by Independent Governance Committees. However, employers cannot take a back seat.

An employer's duty of trust and confidence towards their employees continues beyond the establishment of their pension arrangements. This means they should work with trustees and providers to ensure, as far as possible, that the scheme's investment options continue to meet employees' needs. In addition, they can:

- be vital in ensuring trustees / providers have the member data they need to make informed governance assessments
- add a further level of scrutiny to those assessments
- communicate clear and relevant benefit information to their employees to enable and encourage them to make informed and appropriate saving decisions.

Master trusts

For employers looking for cost efficiency and external pension support, a master trust is an attractive solution. The latest scheme return data published by TPR indicates that 80% of members in automatic enrolment schemes are in a master trust. With an increasing number of smaller employers due to stage in the next few months, this trend looks set to continue.

However, due to their potential impact on the success of automatic enrolment, such vehicles are now in the spotlight. Concerns that a lack of regulation has resulted in a number of weak, and even some fraudulent, providers have prompted the Government to introduce tougher regulatory oversight "as soon as practically

possible". It will be interesting to see how those drafting the new legislation will strike a balance between consumer protection (which is crucial) and the practical challenges faced by master trusts of significant scale.

The [response to HMT's consultation on pension transfers and early exit charges](#) indicates that, ultimately, the Government may establish a "white list" of approved pension providers.

Against this background, employers and trustees looking for longevity in their pension arrangements will need to choose their master trust with care.

Where are we on the "second line of defence"?

Since April 2015, providers are required to ask members about specific aspects of the circumstances that relate to the decision they are making about their pension pot (including health and lifestyle choices) and to provide tailored risk warnings (such as the tax implications of their decisions) in response. This is known as the "second line of defence", the theory being that it will lead people to take a moment's pause before they make their decision. There is no current equivalent for occupational schemes, but the Government intends to give their members similar protection.

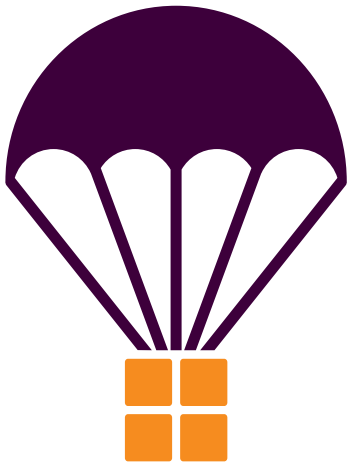
The FCA is consulting on the efficiency of risk warnings and indications are that most members transfer out of trust-based schemes to access the new flexibilities. On this basis, the Government has decided that, for now, generic risk warnings

(covering a number of scenarios) will provide appropriate protection.

It has consulted on draft regulations that will require trustees to provide members with "retirement risk warnings", in writing, at a point after receipt of the retirement "wake up" pack, but before they actually take or transfer their benefits. Specific wording is not prescribed, but each risk warning should include "those attributes, characteristics, external factors or other variables that increase the risk associated with how the member could access their pension savings", fitting with the examples already provided by TPR in its ["Essential guide to communicating with members about pensions flexibilities"](#).

The consultation closed on 15 January 2016.

Spotlight: DC risk and liability management



A common misconception is that in a DC scheme all the risk sits with the members. In fact, trustees must be careful to address potential risks and liabilities in four key areas:

- fund choice
- default fund
- member communications
- DC flexibilities.

1

Fund choice

- Offer members suitable investment options. To do this, trustees not only need appropriate investment advice but also to understand their membership profile. For example, what are members' risk appetites, average contribution levels, pot size and plans for their pension savings?
- Once funds are in place, monitor them at regular intervals, both to ensure they are performing as expected and that they remain appropriate for the scheme. Remember change(s) may be necessitated not only by an influx of members, perhaps following a corporate acquisition, but also members' intentions for their savings altering over time.

2

Default fund

- As most members end up in the default it should represent an appropriate choice for the majority.
- A particular concern is whether the default is keeping up with changes in members' retirement plans. With the advent of the DC flexibilities a lifestyle fund, for example, may not remain the best option for some schemes.

3

Member communications

- Label and communicate members' investment options clearly and accurately so that they are able to make appropriate choices and review the ongoing suitability of their investments.
- Send investment communications at regular intervals (and quickly following any material change in or to a fund, such as a change in the lead manager) both to keep members informed and to prompt them to consider whether to revisit their fund choices.
- Schemes which choose lifestyling structures should ensure members know, well in advance, how and when their investments will be moved.

4

DC flexibilities

- Ensure the scheme's rules match its policy on the DC flexibilities. Beware that ambiguous or unclear drafting may provide members with unintended rights to call for certain types of benefits, for example an UFPLS.
- Keep members' approach to the DC flexibilities under review. Their most likely course of action (eg taking all their benefits as cash or entering drawdown) should inform trustees' investment strategy and, potentially, prompt discussions with the employer on whether a change in benefit design should be considered.
- Make clear which options can only be accessed externally (requiring the member to transfer out), be careful not to (or even appear to) endorse a particular product and encourage members to take financial advice.

Contact

Sackers is the leading law firm for pension scheme trustees, employers and providers. Over 50 lawyers focus on pensions and its related areas, including our DC experts who provide practical and specialist help on all aspects of DC arrangements. 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 specifically on DC issues and developments. If you would like to attend any of our events, please contact us at events@sackers.com or visit www.sackers.com.

Budget special: pensions tax relief – the big reveal	14/04/16	Breakfast seminar (9.00am – 10.30am) With the Chancellor set to reveal the outcome of the Government's consultation on the future of pensions tax relief on 16 March 2016, this seminar will focus on the implications for schemes and savers.
Pensions for new trustees	20/04/16	All day workshop (9.00am – 3.30pm) Aimed at new trustees or those wanting a refresher on DB and DC benefits, this session will look at key legal issues for trustees.
DC hot topics	22/09/16	Breakfast seminar (9.00am – 10.30am) Aimed at trustees and employers of schemes with DC benefits, this seminar will focus on the practical implications of how to deal with the current hot topics.