

Governance of Defined Contribution Pension Schemes

This is the seventh in a series of briefing notes that has been designed to stimulate discussion and to assist those involved in the decision making process around Defined Contribution (DC) pension schemes. We will consider the need for governance of DC pension schemes. This covers all types of DC arrangements – not just occupational schemes, but also AVCs, Group Stakeholder and Group Personal Pensions (GPP).

Background

Governance of DC pension schemes is now high on the agenda for many, not least the Pensions Regulator. It was at a Punter Southall Conference in 2007 that Tony Hobman, the Chief Executive of the Pensions Regulator, signaled the direction his organisation would be taking by stating that: "We are not just a Defined Benefit (DB) scheme Regulator – 85% of all UK pension schemes are small DC arrangements".

The key risk areas which he identified were:

- poor administration
- poor investment policy
- unduly high charges
- poor decisions on retirement choices
- lack of member awareness.

Since then the Pensions Regulator has followed up on his assertions by issuing a wide range of consultation and discussion documents about the governance of all types of DC schemes.

As the DC market has matured, we have also seen many employers, as well as trustee boards, responding to the Pension Regulator's initiative and introducing Governance Plans for the future.

The need for governance

Whether a DC pension scheme has been established as an occupational arrangement, a Group Stakeholder, a GPP or an AVC scheme, it can (and will) benefit from a support structure that helps employers and trustees meet their respective objectives.

When many such schemes, particularly Group Personal Pensions, were originally established they were not regarded as a core employee benefit vehicle, and the level and range of assets under management was relatively low.

This has changed significantly as today many DC schemes are the principal way that employers help their employees save for retirement. At the same time, apart from increased levels of contributions being paid to DC schemes, the de-risking of DB schemes has seen a flow of assets migrated across to DC schemes. DC schemes therefore have in many cases accumulated large funds under management – and these need to be soundly governed.

The need for governance – by employers

Employers' investment in pensions is large, particularly when seen as a proportion of total spend on their employees' overall benefits package. For this reason it is important that employees understand and appreciate the quality and benefits of the pension scheme they are offered and the efforts made by their employer on their behalf.

To do this the pension scheme needs to meet employees' expectations. If the scheme is run smoothly then confidence is maintained, but even a comparatively minor 'hiccup' can often negate any benefits that an employer is looking to derive.

The need for governance – by trustee boards

Trustees have wide ranging legislative and regulatory duties on the governance of DC schemes – including responsibility for administration, internal controls, investment strategy and investment manager selection and monitoring.

What can DC scheme governance look like?

A focussed Governance plan for DC scheme clients can look to achieve the following:

- Minimise the downside – monitor the scheme (i.e. investment fund choice and performance, communication and administration) so it runs smoothly and member confidence is maintained.
- Maximise the return on investment for the employer – agree Key Performance Indicators and define success criteria (i.e. member take-up, appreciation, engagement and reduction in staff turnover).

In turn this can encourage efficiency as a Governance plan will allow employers and trustee boards to consider the needs of their scheme, decide what is required and then budget accordingly. However, governance can be proportionate – one size does not have to fit all.

Minimising risk

To ensure the smooth running of the DC scheme, trustees and employers could consider the following areas:

Pro-active information and awareness – Keep up to date with significant developments affecting the pension scheme and the provision of pensions in the UK generally. This could include:

- relevant prospective legislative and/or regulatory changes
- general developments and best practice in the DC market
- any other significant events affecting the scheme itself including the investment range offered to members, and/or the provision of pensions in the UK generally.

Annual performance review – Carry out an annual review of the DC scheme in order to assess its performance and identify any areas of concern and/or unacceptable risk.

This could cover:

- Investment – identify investment performance against benchmarks and where members are invested (for example, is a member approaching retirement who is invested in stocks and shares aware of the investment risks?).
- Administration – has the provider invested contributions efficiently, paid benefits on time and operated within its service level agreement?
- Overview of the pension provider's standing – are there issues regarding its proposition, capability, performance and general continued suitability that requires discussion?

Maximising benefit

If significant investment is being made into a DC scheme, or there is a focus on the importance of the pension scheme within overall remuneration and reward policies, employers may instead wish to establish a more formal process –

Governance committees and trustee sub-committees – Where appropriate a governance committee might include elected member and union representation as well as have its own Terms of Reference. It can have the look and feel of a trustee board, but without the regulation and red-tape.

Where a trustee board has responsibility for a DB and a DC section, a sub-committee might be set up to focus on DC issues. This may be of benefit where the DB section dominates existing meetings. It is then possible to focus on:

Strategic objectives – Where a pension scheme is seen as a significant benefit, there are often clear objectives

as to what is required. A performance review could consider whether the pension scheme is meeting its objectives, along with any other pension issues that may arise.

Additional services

Having looked to minimise on-going risk and maximise benefit, it is possible to build on this and identify additional services as and when they are required. By doing so the employer or trustee board is being pro-active and is trying to help ensure employees and members appreciate the efforts being made on their behalf.

Some of the additional services could include:

Annual newsletter to all members – A newsletter can be produced each year to keep members informed not only about the scheme itself but also general pension issues and developments and the work of the governance committee or trustee board. This creates a useful audit trail by which to demonstrate that important information has been passed to members.

Investment support for members – Many members of DC schemes can be described as 'unwilling investors' so additional education and support about the investment fund range can encourage take-up and help overcome misunderstanding.

Retirement planning – Having supported employees and members while they are saving for retirement, it is equally important to ensure that they understand the full range of retirement options open to them.

Conclusions

The purpose of a pension scheme is to help save for retirement and governance is a way of helping to maximise those savings. Depending on the scheme size and type, this can be more or less formalised.

Where can I get further information?

For further information please speak with Alison Bostock on 020 7839 8600 or David Ferris on 0117 344 5070. Alternatively you can reach them by email at dcsurvival@puntersouthallgroup.com; or get in touch with your usual Punter Southall Group contact.

This briefing note contains information about products and services offered by companies within the Punter Southall Group. These include companies within the Group that are authorised and regulated by the Financial Services Authority. Our views and expectations do not constitute investment advice and cannot be taken as fact. You are recommended to take independent advice in order to appreciate the complexity of the overall strategy and to consider the level of risk and volatility you are prepared to accept. Past performance is not necessarily a guide to future returns and the value of investments can go down as well as up. Due to this reason, you may get less than was originally invested.

For more information about the Group, visit our website at www.puntersouthallgroup.com

