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BBS briefing note

The role of trustees in DC schemes

The Pensions Regulator has issued a statement clarifying the behaviours and practices it expects trustees of defined contribution (DC) schemes to demonstrate.

This *BBS Briefing Note* summarises the statement and the actions that trustees are expected to take in relation to their scheme.

BACKGROUND

Historically, the core focus on trusteeship has been in relation to defined benefit (DB) schemes. However, the Regulator recognises that there has been a significant rise in DC provision, which is set to increase further once the auto-enrolment legislation comes into force in 2012. Research carried out by the Regulator has also found that governance standards in DC schemes and the DC sections of hybrid schemes (schemes with both DB and DC elements) continue to be poor. The Regulator has therefore increased its focus on DC arrangements over the last couple of years.

In January 2011 the Regulator issued a consultation paper "Enabling good member outcomes in work-based pension provision", which set out how it believed DC schemes should be regulated. *BBS Briefing Note 83* summarised the consultation responses and the actions that the Regulator intended to take.

The Regulator has now issued a Statement, setting out the key differences between DB and DC schemes and how their underlying risks need to be governed differently by trustees.

The Statement reminds trustees that they must have an appropriate level of knowledge and understanding of pension issues to undertake their role effectively and must understand how their scheme operates.

The Regulator has also stressed that trustees owe a fiduciary duty to all scheme members, and that the interests of deferred members must not be overlooked.

Trustees are also reminded that failure to follow the standards outlined could result in the Regulator taking action, i.e. removing trustees and/or appointing an independent trustee.

The Regulator recommends that DC trustees consider their practices in the following key areas, to ensure good governance:

TRUSTEE KNOWLEDGE AND UNDERSTANDING

Trustees should formally assess their collective knowledge and understanding of DC matters and put in place a plan to address any deficiencies promptly, to ensure that they have sufficient skills to manage the scheme.

The Regulator's "Trustee Toolkit", a free e-learning tool, is a good starting point for training and can be found on the Regulator's website

www.thepensionsregulator.gov.uk/trustees.aspx.

CONFLICTS OF INTEREST

Trustees must act impartially and ensure that their decisions are not tainted by an actual or perceived conflict.

A conflicts of interest policy should be produced, setting out how the trustees will identify, monitor and manage conflicts. Trustees should also declare any potential conflicts that they have and record these in a conflicts register.

COSTS AND CHARGES

The charges made under DC schemes often lack transparency. Trustees should strive to ensure that they fully understand the charging structure and what charges are being paid by members.

The trustees must be able to demonstrate that the charging structure offers value for money and that it is applied fairly across all members. Specifically, the Regulator does not consider active member discounts (where deferred members pay higher charges than active members) as fair or acceptable.



INVESTMENT

To ensure that the range of investment funds offered to members remains appropriate, trustees should formally review the funds available on a regular basis.

As a large number of members will select the default fund offered, trustees must ensure that the default fund complies with guidance issued by the Department for Work and Pensions (DWP) in May 2011. This guidance can be found at www.dwp.gov.uk/docs/def-opt-guid.pdf but, in summary, it sets out how trustees should go about designing, monitoring, reviewing and communicating a default fund.

ASSET PROTECTION

The overriding message is that trustees must invest prudently. Assets should, predominantly, be invested with entities registered with the Financial Services Authority (FSA) and, where they are not, the trustees must demonstrate and communicate to the members why the unregulated investment option offered is appropriate.

Trustees must establish and understand what protection is available to members should an investment provider default, in particular the level of protection offered by the Financial Services Compensation Scheme.

ADMINISTRATION

The Regulator suggests that trustees should meet at least quarterly to discuss governance issues. They should consider how to identify, manage and monitor the key risks to the scheme and record these in a risk register.

It is vital that DC scheme records are accurate and updated in a timely fashion. The quality of administration and record-keeping should be continually assessed by the trustees.

Where services are outsourced, assurance should be sought on the operational effectiveness and internal controls of providers, for example, via an independent assurance report such as an AAF01/06 report.

CONTRIBUTIONS

Members should be made aware that the level of their eventual pension ultimately depends on the contributions paid and investment returns earned over the pre-retirement years.

It is fundamental that trustees ensure that the correct contributions are paid over to the scheme on a timely basis and that any issues relating to late payments are resolved.

If a scheme is to be used to meet auto-enrolment requirements, trustees should ensure that processes are in place to deal with the additional demand.

BBS VIEW

The Regulator has been a key driver behind the successful raising of governance standards in DB schemes over recent years. We therefore welcome this guidance in relation to DC schemes, where the need for good governance is arguably greater as it is the members who are taking on many of the inherent risks rather than the employer.

The Statement is useful not only for DC trustees but also for demonstrating to employers the importance of putting in place governance committees to manage their contract-based DC schemes.

The statement will also be of relevance to trustees of DB schemes that have Additional Voluntary Contributions (AVC) arrangements in place.

BBS will be working with its clients to ensure that the standards laid down by the Regulator for DC schemes are met.

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