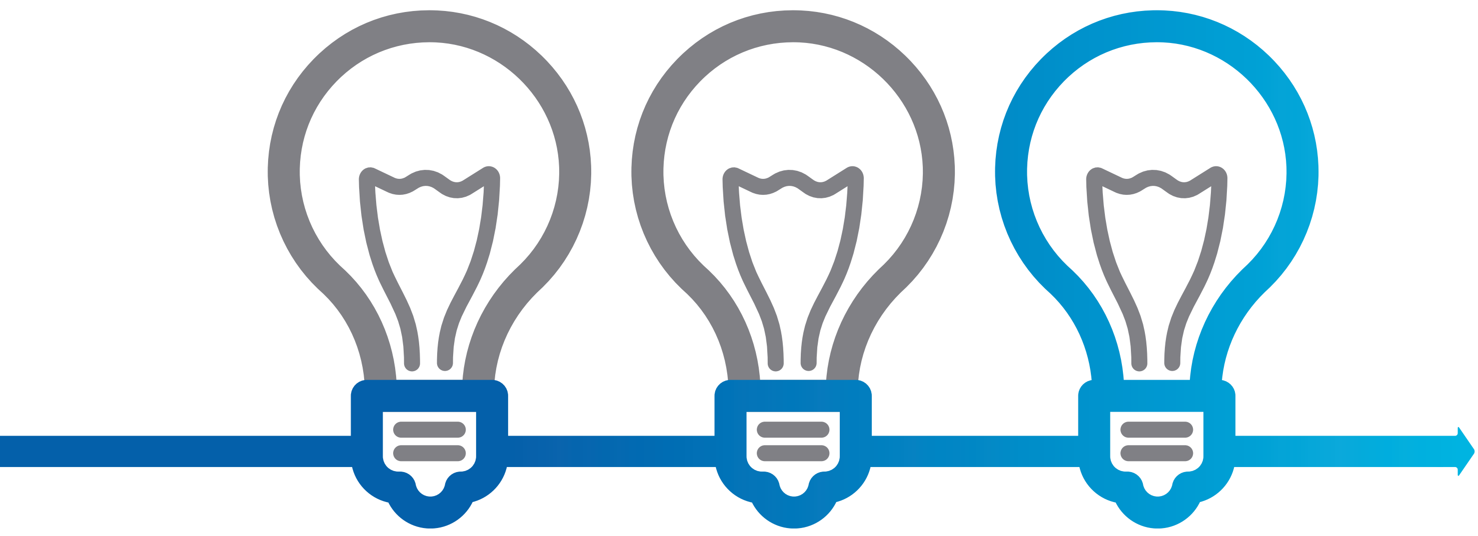
the people's pension

Key considerations guide

For single-employer defined contribution trusts operating in the pensions market



For people, not profit

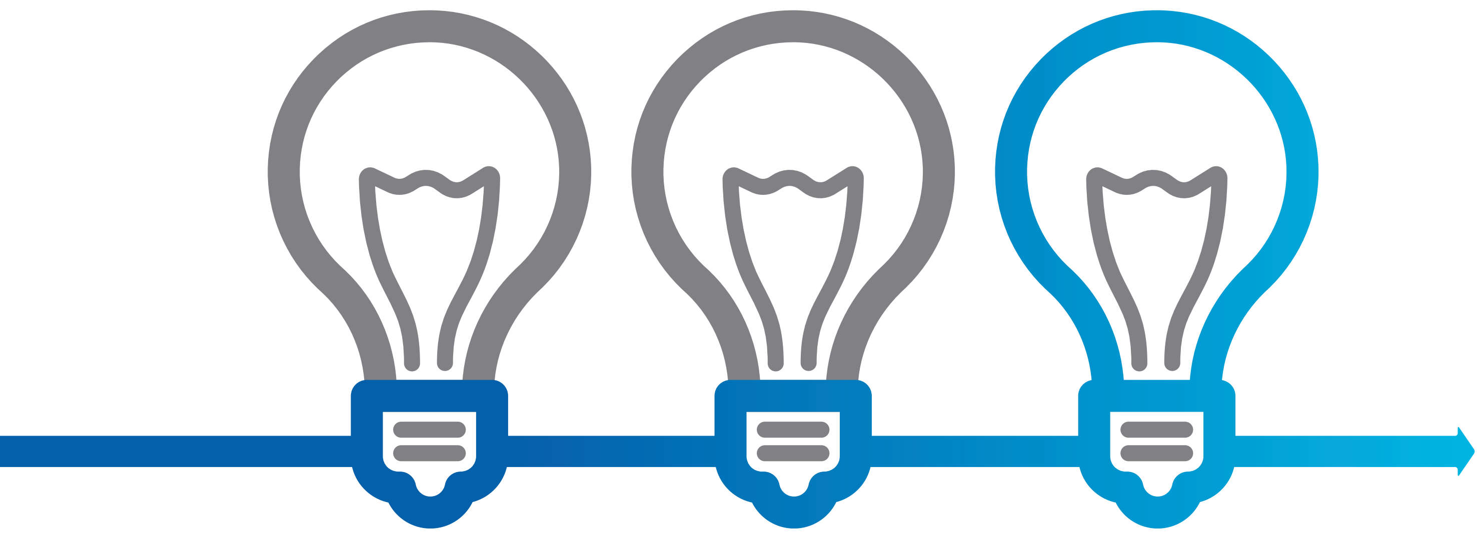
Contents

Introduction

This guide gives an overview of the pensions market over the last few years. It covers the impact changes in regulations have had on single-employer defined contribution trusts and why scheme sponsors and trustees may be required to think more about the relationship between scale, cost, governance and sustainability.

It highlights the difficulties they may face in continuing to operate in the pensions market and presents the options available if, following a review, a decision is made to make a change.

Finally, this guide provides ideas on how to organise a project and key considerations scheme sponsors and trustees may adopt in looking to find a new provider.



Please note, this is not a customer advertisement. This guide is intended for scheme sponsors and trustees of defined contribution occupational pensions only.

Changes in the pensions market

The pensions industry has gone through substantial changes over the last decade to strengthen scheme oversight.

The Pensions Regulator (TPR), Department for Work and Pensions (DWP) and the Financial Conduct Authority (FCA) have been the main drivers for change in the market. Originally their focus centred on the legal duties of defined contribution (DC) pension schemes and boosting retirement savings. Although, this emphasis on pension schemes' legal duties remains paramount, there has now been a shift towards driving up the quality of workplace pensions for better member outcomes.

It's expected that tighter regulations will continue and that a move towards consolidation in the market, led by TPR and the DWP, will challenge the continuation of some single-employer defined contribution trusts. As stated by Louise Sivyer, TPR's Policy Manager in September 2018:

"Where we find trustees, who are unwilling or unable to take action to improve their standards of governance, we will work with these trustees to help them make sure their members' benefits are protected and that will include encouraging them to consolidate into better run, better value schemes...".

A more regulated pensions environment

Key regulations from the last 5 years and their potential impact on DC pension schemes.

Removal of the short service refund

From 1 October 2015 legislation removed the option for scheme sponsors and trustees of DC pension schemes to allow members to take short service refunds in their first 2 years of membership. Since then, many active DC pension schemes have seen a significant rise in their membership and a proliferation of small pots. The consequence for those who previously offered this option is a significant increase to the running costs and future complexities in tracing members as they inevitably change their addresses.

Annual management charge cap for 'qualifying schemes'

From 6 April 2015, the default investment arrangement used by employers to meet their workplace pension duties became subject to a charge cap of 0.75% per annum. This has had a varying effect on the pensions market. Smaller DC pension schemes who follow an actively managed investment approach may find it difficult to manage their default fund within this charge.

Emphasis on good governance

In 2016 TPR launched an ongoing programme which outlined their expectations on effective scheme management. This was based on their paper on '21st Century Trusteeship' and governance.[1]

The regulator made it clear that these weren't additional requirements for higher standards across the pensions sector, but clarity on how a well-governed scheme should look regardless of its size.

Due to this focus on governance, trustees may find themselves under further scrutiny from the regulator to be attentive to areas such as:

- their roles and responsibilities
- having a diverse Board in place
- existing relations with their employers
- robust risk management when producing the scheme valuation
- time management over completing the scheme return
- paying their levy.[2]

To support trustees in meeting these more succinct governing standards, the regulator has published guidance setting out their expectations for good governance in 9 key topic areas and the consequences for those who don't meet them. For more information, visit the regulator's webpage on **21st Century Trusteeship**.

Trustees can also visit the regulator's website to look at their **checklist for good governance**.

[1] For more information visit the regulator's webpage on '**21st Century Trusteeship**'.
[2] More information can be found in the regulator's blog, '**21st century trusteeship – why standards need to rise**'.

Requirements for further transparency in annual statements

The Chair's statement

Since 6 April 2015 trustees of DC pension schemes are required to produce an annual governance statement signed by the Chair to show how they comply with governing requirements. Failure to provide this information has led to schemes being fined between £500 to £2,000.

Nicola Parish, the Executive Director for Frontline Regulation at TPR commented on the importance of a chair's statement:

"Annual chair's statements are an essential way to show pension savers that their scheme is being properly governed and will deliver the retirement benefits they are promised. That's why it is the law for trustees to produce chair's statements and make sure they contain all of the necessary information." [3]

To provide scheme sponsors and trustees with more information, TPR published '**a quick guide to the Chair's statement**' setting out their requirements and a checklist.

Investment charges and transaction costs

From 6 April 2018, trustees are required to disclose the level of charges and transaction costs for all their investment funds, including the default fund, within the annual Chair's statement. This information needs to be publicly available on their website and be linked to from within members' annual benefit statements. The information is designed to show pension savers the true cost of investment but adds further work to DC pension schemes' existing roles and responsibilities.

Visit TPR's website for more on their **emphasis on investment governance**.

Pressures to offer members better investment choices

Scrutiny on pension scheme default arrangements

By law, trustees must review their default strategy and the performance of their default arrangement. This must be done every 3 years, or when there's a significant change in their investment policy or member demographic. Trustees should check their default arrangement is performing as expected and that their default strategy ensures investments are made in savers' best interests. In June 2019, TPR launched a pilot which involved contacting trustees to confirm they were reviewing their default arrangement and meeting their legal obligations.

David Fairs, Executive Director of Regulatory Policy, Analysis and Advice at TPR, has commented:

"This pilot is among some of the things we are doing as part of a new approach to contact trustees about their legal duties, support them to become compliant where we can and inform them about the alternatives – including winding up their scheme – if they do not or cannot meet the standards which we expect."

More on this within TPR's press release, '**TPR lifts the bonnet on default investment governance**'.

Diversity in investment pathways and transparency within member 'wake up' packs

Since the pension freedoms, the FCA have indicated that contract-based DC schemes should offer more diverse investment options to their members. The FCA's 'Retirement Outcomes Review' report in 2018 revealed that savers were simply choosing to take their 25% tax-free cash while disregarding the investment of their remaining pension pot.

This concern has led the FCA to propose that pension providers should offer members 4 simple 'default investment pathways'. These pathways should be designed to support members in the long run by reducing the risk of their income becoming exhausted when they come to accessing their pension savings.

It has also been mandated that the regularity of retirement 'wake up' packs for older members should be increased with further transparency on retirement options and costs. Read the FCA's press release for **more about investment pathways and plans to improve retirement outcomes for members**.

Many trust-based schemes are taking account of developments in the contract-based market when considering their future investment proposition in anticipation of rules from the DWP.

[3] For more information read the regulator's press release, '**Schemes warned to comply with law on chair's statements**'.

A focus on stewardship and new environmental, social and governance (ESG) guidance

From 1 October 2019 trustees are required to set out how they take account of financially material factors and stewardship, including ESG factors. ESG factors include environmental, social and governance considerations when selecting investments. Prior to this, trustee boards have been 'expected' to factor in climate change risk into their investment strategies. Any trustees who choose not to meet these requirements will need to explain how it won't have any impact on investment returns or income for their members.

A significant amount of time and focus will need to be put aside by trustees to ensure they're adhering to this new requirement correctly. To support trustees, The Pensions and Lifetime Savings Association released a guide, '**ESG and Stewardship: A practical guide to trustee duties**'. It covers what trustees should do to ensure ESG, climate change and stewardship factors are taken on board and reflected within their pension scheme.

Difficulties in providing workplace pensions – the impact on smaller DC occupational trusts

Requirements of time, resource and cost can present major issues for some smaller DC pension schemes looking to meet the increasing regulatory requirements (set out in the section above).

What's more, auto-enrolment created a change in the pensions landscape, with larger DC pension schemes growing substantially in membership and assets under management, relative to many smaller DC pension schemes.

As a result, in the last decade there has been a clear decrease in the number of small DC pension schemes registered. Statistics from TPR revealed that the number of pension schemes with 12 and over members have more than halved between 2009 and 2017 from 4,570 to 2,180.

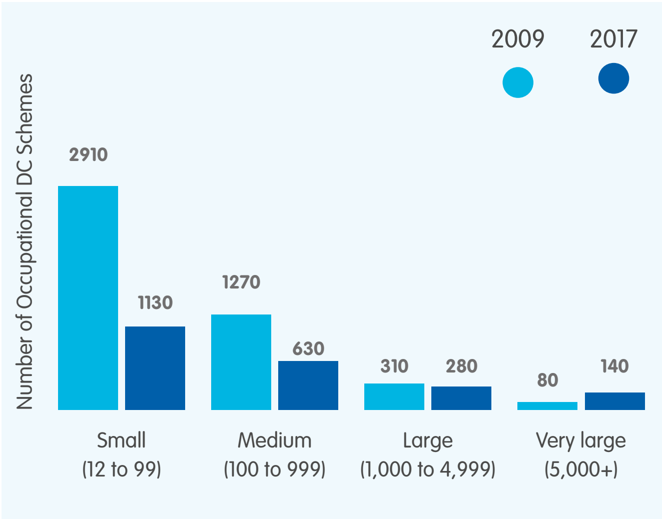
The pie chart (bottom right) – from a report conducted on behalf of TPR in May 2019 – reveals the struggles micro and small DC pension schemes have faced, in recent years, compared to larger DC pension schemes in meeting regulatory requirements. These requirements were based on the regulator's 5 key governance requirements (KGRs), which were as follows:

1. Trustee boards must possess or have access to the knowledge and competencies necessary to properly run the scheme.
2. Trustee boards must assess the extent to which charges/transaction costs provide good value for members.
3. Core scheme financial transactions must be processed promptly and accurately.
4. Trustees of master trusts must meet independence requirements (applicable only to master trusts).
5. Trustee boards must ensure the default investment strategy is suitably designed for their members (applicable only to schemes with a default investment strategy).[4]

According to the report, larger DC pension schemes were able to meet 84% of the regulator's KGRs in contrast to micro and small DC pension schemes who only met 12-15%. Additionally, the more members in a pension scheme, the more of the regulator's KGRs were met.

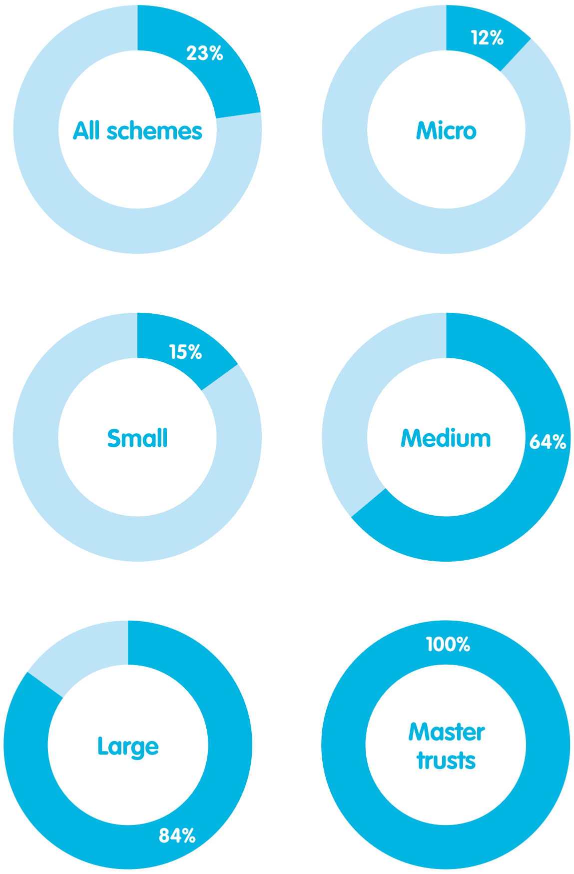
By reflecting on the increasing regulations, larger DC pension schemes have become more equipped to adapt to these rising industry standards. This suggests some smaller DC pension schemes may begin to seek out alternative means to ensure their members are receiving the best solution.

Trends in DC pension scheme numbers, by size



Source: The Pensions Regulator, DC Trust – schemes with 12+ members, includes hybrids

Proportion of schemes meeting 2 or more KGRs



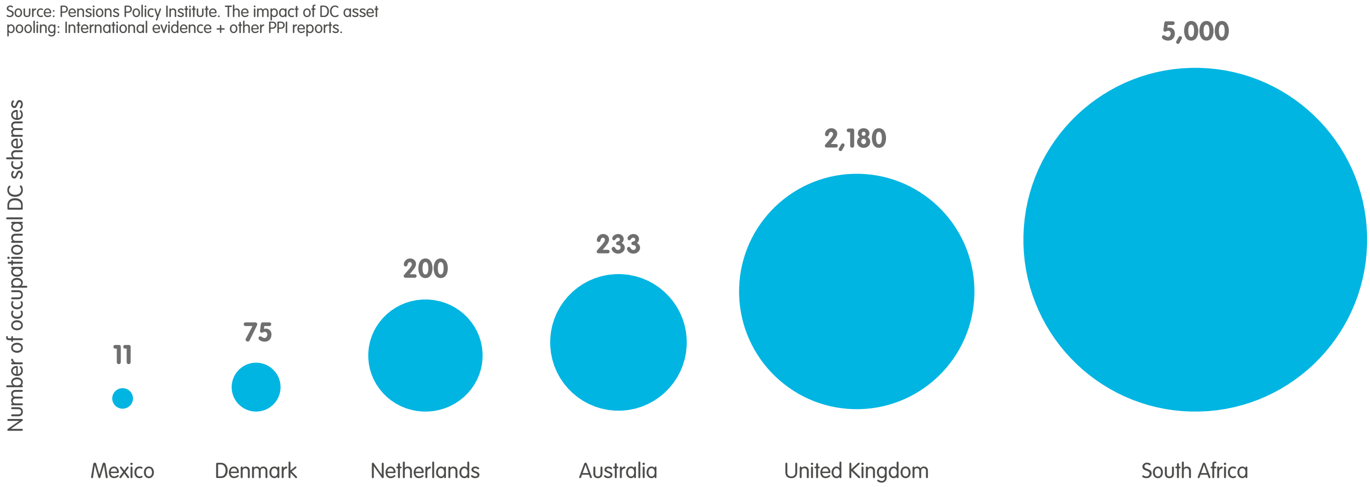
Source: The Pensions Regulator report, 'Defined Contribution trust-based pension schemes research', May 2019

[4] Report conducted on behalf of TPR by market research company, OMB research, in May 2019. Read the **regulator's report** for more information.

More transfers on the horizon

UK DC occupational schemes market is extremely unconsolidated

Source: Pensions Policy Institute. The impact of DC asset pooling: International evidence + other PPI reports.



Although the above diagram shows the UK market as unconsolidated in comparison to other countries, the pensions industry expects this to change. The belief is there will be a rise in transfers, with larger DC pension schemes absorbing the membership and assets under management of smaller DC pension schemes.

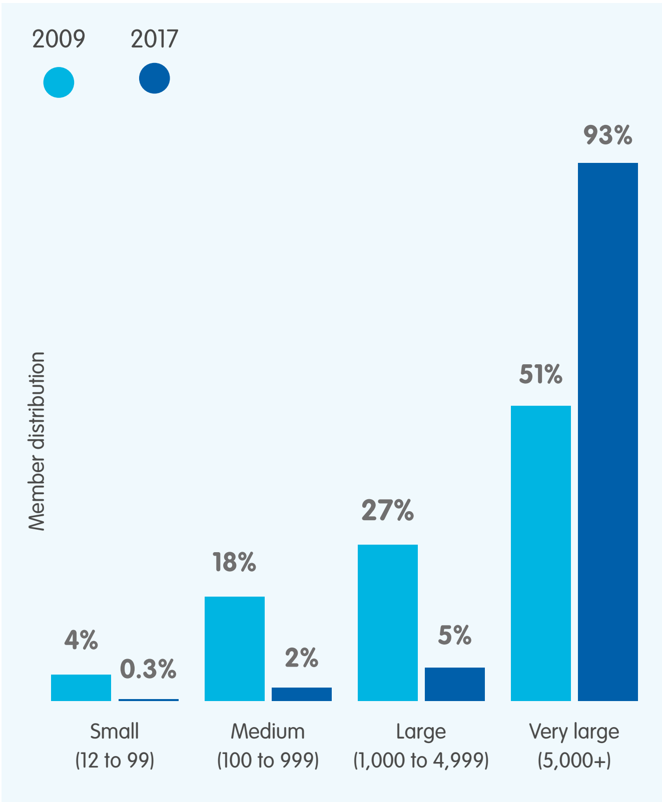
Changes within industry requirements around transfers has simplified the process for DC pension schemes looking to move. For instance, The Occupational Pension Schemes (Preservation of Benefits and Charges and Governance) (Amendment) Regulations 2018 removed the need for trustees to obtain an actuarial certificate unless members have valuable in-scheme benefits such as guaranteed investment returns or annuities. Additionally, professional advice to scheme sponsors and trustees is no longer a requirement if a pension scheme is moving to an authorised master trust.

The graph (to the right) shows a significant and growing difference in scale of membership between large and small sized DC pension schemes between 2009 and 2017. Large authorised master trusts are now more than ever well placed to be considered alongside contract based 'buy out' options, especially when the sponsoring employer has auto-enrolment duties.

A move from unbundled to bundled arrangements

Unbundled structures have allowed scheme sponsors and trustees to cherry pick various services – relating to investment, administration and communication for their scheme – this often brings increased costs. Scheme sponsors and trustees, with greater reason, will need to seek the best outcomes for their members. This could be best served by bundled pricing structures and services offered by one provider.

Trends in DC pension scheme numbers, by size and memberships



Source: The Pensions Regulator, DC Trust – schemes with 12+ members, includes hybrids

Key considerations – options in the market

Essentially scheme sponsors and trustees of a single-employer defined contribution trust have 3 options when deciding how they continue operating in the market. These decisions though driven by financial and regulatory factors and pressure from governing bodies, will also be influenced by their organisation's culture, staff profile, and ability to achieve better member outcomes.

These options include:

1. Continue with their current pension arrangement and governance.
2. Initiate a strategic review of the pension scheme in the context of their business model and the performance of other pension arrangements.
3. Wind up their pension scheme and look for an alternative arrangement.

Initially, when conducting a review, there could be opportunity to reduce the size and cost of an occupational arrangement and maintain it going forward. Or to follow a series of steps over a long timeframe, to move away from running a single-employer defined contribution trust. Plans to transfer all or a section of deferred members to another arrangement, for example, would potentially reduce costs and allow a focus on active members.

Routes to take with members' assets

Before starting, it's essential scheme sponsors and trustees review their scheme's trust deed and rules to understand their ability to handle member assets and where required, make appropriate updates.

There are potentially 3 routes to take when deciding where to direct members' current assets within a DC pension scheme. Each has its own unique features and considerations.

Contract-based scheme

Generally available from traditional insurance company providers and referred to as Group Personal Pensions (GPP), they are in effect a series of individual contracts for each member. This changes the governance structure supporting members from their current arrangement to operate under a different legislative regime overseen by the FCA.

A GPP doesn't have a trustee board with legal responsibility for running the scheme. So, if a GPP is no longer acting in the members' best interest, there isn't a board in place with power to change the underlying investment provider and administrator. Instead a GPP has an Independent Governance Committee (IGC) which holds an advisory rather than executive role and does not have the same legal powers as trustees. They can raise concerns with the provider's board who are required to take 'reasonable steps' to address the IGC's concerns. Providers are permitted to deviate from the IGC's recommendations (on the basis that they provide a written explanation), leaving IGCs with the alternative of merely reporting their concerns to the FCA.

Visit the FCA's website for **more about IGCs**.

If contributions need to be made on behalf of members, a GPP is then a viable choice.

One drawback of a GPP is that as a series of individual contracts, the scheme sponsor and trustees are unable to mandate the move of the remaining assets in the pension scheme unless they get express written consent from each member. This is problematic when looking to wind up a DC pension scheme as assets from those members who cannot be contacted and/or fail to respond would remain.

Trustee buyout plan

These arrangements are provided by traditional providers and may also be referred to as a Section 32 policy. This is because this is the 'section' in the Finance Act 1981 that referred to deferred annuity contracts. It can also be referred to as a 'buyout' policy, as the members' benefit rights have been 'bought out' of the registered pension scheme.

Buyout policies assist employers and trustees with discharging their liability on the winding-up of a company pension scheme and removing groups of members from a defined benefit (DB) or DC pension scheme without their consent. They're unable to accept ongoing contributions from the employer or members in the future. So, for open pension schemes, buyout policies are not a complete solution and need to be used alongside another arrangement. In addition, this policy cannot accept any further transfers from other pension pots the member may wish to consolidate.

What's more, buy-out plans are also not governed by IGCs and policyholder charges are not subject to the auto-enrolment 0.75% charge cap.

Master trusts

Master trusts operate under the same regulations and legislative regime as single-employer defined contribution trusts. This means that the trustees have the same direct responsibility toward members' best interests.

What's more the master trust authorisation regulation, which came into effect on 1 October 2018, gave TPR further powers to ensure ongoing assurance of good governance of such schemes. By strengthening the underpinning financial covenants, smaller less capable schemes are being removed from the market. It's also increased the focus on governance by trustees, scheme sponsors and regulators alike.

Master trusts allow trustees to discharge their liability when winding-up or removing members from a DC pension scheme without member consent (this is subject to the ceding scheme's deed and rules having sufficient powers, though an amendment could be executed to enable this). They can accept ongoing contributions from both the employer and member together with deferred benefits in one arrangement, whilst also allowing the member flexibility. This includes flexibility to use the master trust scheme to consolidate additional pension pots or as a retirement savings vehicle for the member in the future.

Glimpse at the 3 market options

	Contract-based schemes	Trustee buyout plans	Master trusts
Trustee governance	✗	✗	✓
Regular contributions	✓	✗	✓
Pension pot consolidation	✓	✗	✓
Non-consented transfers	✗	✓	✓

Planning approach when choosing another pension provider

When considering another pension provider, there are a number of considerations and steps to take. Below are 10 key areas to review before deciding.

1. A unified project team

If the decision is to make a change to the current pension scheme, by:

- diverting contributions to another arrangement
- transferring some of the membership
- completely winding up.

It's important to set up a project team. This may involve the employer as sponsor, trustees, employee representatives, third-party advisers, administrators and pension scheme providers.

Meeting the needs and expectations of scheme sponsors, trustees, members and other interested parties can be tricky. It's important to establish a list of key requirements and a potential timescale that everyone can agree to from the start. This could look at the needs and functionality required by members and the business and characteristics of the potential provider, to generate questions as part of a due diligence process.

2. Provider commitment

Can the pension provider demonstrate credentials, history and commitment to the corporate pensions market? Do they have scale and forecasts for growth to sustain a long-term proposition which will develop to support the needs of members and employers? Do they have the scale in order to provide cost-effective solutions for members?

3. Standards of governance

Before selecting a pension provider, check there's strong governance in place and that the provider's business strategies meet expectations and are in members' best interests.

TPR's 9 topic areas of good governance from their 21st Century Trusteeship campaign could help with reviewing provider governance. These topics include:

1. Good governance
2. Clear roles and responsibilities
3. Clear purpose and strategy
4. Skills and experience
5. Advisers and service providers
6. Managing risk
7. Managing conflicts of interest
8. Meetings and decision-making
9. Value for members

Visit the regulator's website for **more about their 21st Century Trusteeship campaign**.

4. Flexibility and support

Weigh up the flexibilities the other pension provider can offer:

- Will the pension provider allow employer contributions?
- Is there opportunity for members to make contributions in future?
- Are members able to consolidate other pension pots?
- How accessible is support through contact centres?
- What reporting functionality is available to employers?
- What ongoing support through communications and tools are provided to both employers and members to help maintain the scheme and drive better member outcomes?
- Does the pension provider offer a full range of retirement choices including drawdown options, small lump sum payments, access to the annuity market for members?
- Does the pension provider offer clear signposting and access to guided or regulated advice?
- Does the pension provider offer both tax bases (net pay arrangement and relief at source) for contributions?

5. Investment choice

Review whether there are any similarities between the investment options of the existing pension scheme to that of the pension provider.

Think about:

- How does their default fund differ?
- What options are there for members to select alternative funds to cater for differing risk appetites as well as ethical and religious requirements?
- Does the default fund consider climate change, infrastructure investment and ESG factors?

6. Protected tax-free cash

When considering a pension provider, checking whether they support protected tax-free cash could be a key feature to look out for.

Protected tax-free cash relates to the amount a member could take from their pension before April 2006 based on their length of service and remuneration. Before this changed to the standard 25% tax-free cash, the Finance Act 2004 looked to protect those who could receive more than 25% tax free. This was by ensuring their cash entitlements were acknowledged by pension schemes.

Scheme sponsors and trustees should identify how many of their members have this tax-free protection before deciding whether:

- their chosen scheme will uphold their members' protection
- it would be feasible to leave their members in their existing scheme
- to not go ahead with the transfer.[5]

7. Additional voluntary contribution arrangements

Members with both DB and DC additional voluntary contributions may have a right, under the rules of the transferring scheme, to use all their savings to provide their tax-free cash before exchanging any of their DB pension. This is a key point to consider when transferring DC benefits to another arrangement. If they do, then transferring-out their DC pension pots (breaking the link with their DB entitlement) would not (apart from those with pre-2006 entitlement) affect the tax-free cash they can take. However, it might materially worsen the terms upon which they can take it.

8. Trustee powers and communication

Lots of data will be transferred to the chosen provider. It's important to think about the terms and process for this as well as ongoing arrangements for data processing and security:

- Review the scheme rules to check trustee powers to transfer money on the members' behalf and make necessary amendments to rules ahead of any proposed wind up.
- Ensure there's a robust process for cleansing data and check that contact details (especially for deferred members) are up to date.
- Ensure a consultation takes place for schemes with over 50 members.
- All members must be written to at least a month before the transfer setting out the proposed plan. This communication should provide details of the new default provider and options for them to choose an alternative arrangement.

9. Transition costs

Below is a list of potential costs to consider during the transition to another pension arrangement:

- Associated legal and professional advice costs
- Costs from any third-party administrator
- Time cost for internal staff in the project
- Data cleansing and deferred member contact detail search costs
- Set up and ongoing employer charges in respect of the new arrangement
- Communication costs to inform members of the move, and their investment and retirement options
- Transaction costs and pre-funding agreements

Managing the migration process through careful planning will keep costs down. Check with the pension provider to see if any project management support is offered as part of the transfer process and if any charges are made for project management and implementation support.

Visit TPR's webpage on **winding up and costs** to find out more.

[5] For more information read the blog post by Gateley, '**DC transfers from hybrid schemes: Have you considered protected tax free cash?**'

10. Timescale and other interested parties

The process of a full wind up can take up to 2 years to complete depending on complexity as it involves multiple stakeholders, namely scheme founders, advisers, employers, third-party administrators, lawyers and trustees. So, it's important to make sure everyone is clear on what's happening, when and why.

It's crucial to hold regular meetings with stakeholders to update on progress and manage expectations. By having one person responsible for overseeing the process from start to finish and managing and re-planning agreed timelines with all parties, it will help maintain momentum, minimise duplicated effort and potentially shorten the process.

Summary

By reflecting on pension industry developments and changes to rules and regulations from the DWP, TPR and FCA, there's an observed momentum towards change.

This guide provides single-employer defined contribution trusts a starting point to reflect on these growing requirements and their ability to continue operating in the market against larger DC pension schemes.

While this guide has outlined key considerations and routes pension providers can take, they need not be binary and can be an evolving programme of short and longer-term changes. What's clear is that decisions should take into account the impact on both scheme sponsors and trustees and most importantly, be centred around members' best interests.

What's next?

If you're thinking about consolidating and would like to talk about the support we can offer if you joined The People's Pension, contact us on **0333 230 1322** or email us: **consolidation@thepeoplespension.co.uk**

For more about who we are and what we do, take a look at our **corporate brochure**.

Glossary

Actuarial certificate
A legal document where an actuary certifies that in their opinion, the transfer credits to be acquired for each member under the receiving scheme as part of a bulk transfer, are 'broadly no less favourable' than the rights to be transferred.

Bundled and unbundled arrangements
A bundled pension scheme is where the administration, investment and member communications are managed by a single provider. An unbundled pension scheme however, is when investments are handled on a dedicated investment platform, with administration and member communications being carried out by a third-party administrator.

Environmental, social, and governance (ESG) factors
A term used to identify investments which are environmentally beneficial over the long term.

Independent Governance Committee (IGC)
A requirement from the FCA set up by contract based providers of workplace pensions to offer advisory input on the running of a pension scheme.

Key governance requirements (KGRs)
Relates to the 5 key requirements set out by TPR.

Master trust authorisation
A specific authorisation and supervisory regime, overseen by TPR to ensure master trusts are run by 'fit & proper' persons, are financially sustainable and are run in members' best interests.

Protected tax-free cash
The amount of tax-free cash a member could take from their pension before April 2006 based on their level of service and remuneration.

Short-service refund
Applicable to members of occupational defined contribution pension schemes before 1 October 2015 who could receive a refund of their contributions if they left the scheme within 2 years.

Wind up
When a defined contribution pension scheme decides to cease operating in the market.

For more information:

0333 230 1322

consolidation@thepeoplespension.co.uk

www.thepeoplespension.co.uk

B&CE Holdings Limited
Manor Royal, Crawley, West Sussex, RH10 9QP. Tel 01293 586666. www.bandce.co.uk

TPP GD 0001.0819