Governance of DC Schemes

Defined Contribution (DC) schemes are not a new concept. Many Defined Benefit (DB) schemes have been closed to new hires and now, increasingly, are closing to future accrual and being replaced with DC schemes.

The question that arises is: how much attention has been paid to the running of the DC section or scheme? From experience, trustees often devote a significant amount of their meetings to issues relating to the DB section but very little time is spent looking at DC issues.

As we head further along the path of recession, more and more companies will be considering whether a change in their scheme design is needed and many more could be turning to DC as a potential solution.

Whatever the outcome, from a governance point of view it is imperative that companies and trustees have a proper structure in place to ensure that the scheme works in the best interests of the members; a requirement under a trust but equally important for contract-based schemes.

On the Regulator's radar

The Pensions Regulator's approach for all workplace pensions, whether trust or contract based, is centred on providing education and guidance to trustees but it will intervene if there are persistent problems.

DC is very much on the radar of the Regulator and it is keen to promote the need for better governance within DC schemes, producing guidance documents on:

- effective communications;
- making pension fund choices; and
- member retirement options.

There are also proposed changes within the Trustee Knowledge and Understanding guidance that sets out clearly what trustees of DC schemes should consider.

The Regulator has also identified some key DC risks:

Poor investment practices

Poor performance can significantly impact members' benefits and steps need to be considered to mitigate the risk that investments persistently underperform. A rigorous manager selection and regular review processes also need to be created to ensure reliable performance and that they remain fit for purpose. It is extremely important that both members and trustees are equipped to make appropriate investment decisions and in good time.

Poor administration practices

Accurate and timely record keeping is vital for all types of schemes but for DC this means regular and accurate contribution reconciliations, preferably at least monthly. There are obvious risks if this doesn't happen. For example, reconciliation will prove more difficult if neglected for several months and the problem is compounded with the passage of time. If member unit holdings are not correct, benefit quotations may be inaccurate, perhaps even overstated, and the audit may be compromised. This in turn may lead to member complaints when definitive benefits come to be processed.

Unduly high charges

Charges impact on the level of benefits a member will receive. Trustees should review the level of charges on a regular basis to ensure value for money. Trustees should also consider how they can make the provision of information on costs to members more accessible. High costs will eat into members' benefits.

Poor decisions on retirement choices

Do members have the right information to make informed choices? Is there sufficient communication around the various types of annuities that members can opt for at retirement? The open market option is still largely underused and this can also impact on a member's benefits.

Lack of member understanding

Processes need to be in place to allow members easy access to existing information relating to the scheme. Communication should be in plain English and cover what the member needs to know to make informed decisions. It is beneficial to identify what keeps members interested and engaged. Taking this a step further, it may prove particularly effective to identify distinct membership groups so as to provide more targeted communications.

From a trustee perspective, this is beneficial because this will aid members in making the best choices for themselves and hopefully lead to fewer complaints, in turn reducing management time and cost. From a company perspective, members are also employees and it is important to maintain a happy workforce. It also means that the company is less likely to be accused of apathy or even neglect.

To date, we have read many articles talking about the need to improve member communications. We all agree with that, but companies and trustees need to ensure that the structure of their scheme is in good health with good, solid processes and procedures in place.

Available tools

Of course, it is important to comply with the Regulator's guidance, and there are tools that can help monitor the management, administration and performance of the scheme.

One of the first key items for every scheme is a governance or business plan. Other tools that help with the monitoring process are a risk register, e-tools from particular advisers, comparison with Myners' principles, and having an effective training plan to ensure that all parties linked to the plan have a proper understanding. Trustees and companies may wish to consider using DC interrogation services to provide meaningful information on member behaviour and thus be able to target those at higher risk.

It doesn't matter whether your DC scheme has been running for years, whether you have just opened a relatively small DC section, or whether you have a legacy AVC vehicle within a wider umbrella of benefits, you still need to make regular reviews of the health of your scheme arrangements. And you will also need to be prepared to make changes to ensure that your scheme doesn't become a juggernaut that is too difficult to steer.

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