SQUIRE SANDERS

DC PENSIONS UP IN THE AIR

Getting a Grip on the Issues

April 2014

The DWP Command Paper "Better workplace pensions: Further measures for savers" was issued on 27th March and a consultation process on some aspects of the paper has commenced. This is the latest in a long line of recent measures and planned changes aimed at improving the regulatory framework for Defined Contribution pension arrangements.

With so many DC issues up in the air it's not possible to cover them all so in this communication we focus on the key issues set out in the Command Paper and some of the likely actions needed. We also highlight some of the ways in which the Command Paper interacts with other developments in the DC market. Nothing that improves DC standards can really be objectionable but there are undoubtedly challenges for trustees, employers and providers to meet in considering and complying with the numerous requirements being imposed on them in a very short time-frame (including those arising from the 2014 Budget).

The Command Paper aims to:

- Improve value for money, quality standards and transparency in DC workplace pensions – both trust and contract based.
- Achieve more consistency between trust and contract based pension plans.
- Reduce member borne charges on pension plans that are "qualifying schemes" (for the purposes of satisfying employer duties under the Pensions Act 2008).
- Complement the 2014 Budget DC pension reforms.

Command Paper Timetable:

The DWP's consultation runs until 15 May 2014 – Squire Sanders will be submitting a response to the consultation so please let us know if you have any comments or views which you would like us to include.

From April 2015:

- New minimum standards to ensure quality and prioritise members' interests.
- Increased transparency on costs and charges.
- Charge cap of 0.75% of funds under management in relation to default funds of DC qualifying schemes (this cap excludes transaction costs to be reconsidered in 2017).
- Consultancy charges banned in relation to default funds of DC qualifying schemes.

From April 2016:

- Member borne adviser commissions and active member discounts (the practice of charging deferred members more than actives) banned in DC qualifying schemes.

From April 2017:

- The Government to consider whether the charge cap should include transaction costs.

Key Measures

The Command Paper proposes that all DC workplace pension plans must comply with a series of overarching standards which include: being governed by an independent body with a duty to act in the interests of members; raising standards of performance and administration; and reducing member borne costs and charges.

For trustees who are already complying with the Pensions Regulator's 31 DC Quality Features, complying with the Command Paper's quality and governance requirements should not be additionally onerous. The Pensions Regulator's 31 DC Quality Features already set a high standard and contain more detail than the Command Paper. No doubt the Pensions Regulator (who will enforce the new requirements for trust-based plans) will need to revisit its existing DC material once the DWP has responded to consultation and a more settled position is established.

Contract based pension plans will also have a duty to comply with the overarching standards (mentioned above) and more work will be required to bring all contract based pension plans up to the required standards, both from the providers who run them and from the employers who contribute to them in respect of their employees. The key change for contract based plans is the proposal to have Independent Governance Committees in place which have a duty to act in the interests of the members of the pension plan.

This is a significant shift from the current position where employer-chosen contract based plans are run by insurers in their own commercial interests (subject to FCA requirements) with no one looking out solely for the interests of the members.

For mastertrusts, there will be additional requirements due to concerns about independence: we expect the publication in the summer of the new assurance framework for mastertrusts from the Institute of Chartered Accountants in England and Wales and the Pensions Regulator, and we will issue a separate update at that time.

The Six Governance Requirements for DC Pension Plans

- Default investment strategies must be designed in the interest of members, with a clear statement of aims, objectives and structure and how these are appropriate for their membership.
- Characteristics and net performance of default investment strategies must be regularly reviewed to ensure alignment with the interests of members and action taken to make any necessary changes.
- Core scheme financial transactions to be processed promptly and accurately.
- Levels of charges borne by members to be assessed.
- Costs incurred through investment of pension assets to be assessed.
- Trustee boards and Independent Governance Committees must have or have access to all of the knowledge and competencies necessary to properly run the pension plan (but note that there is no requirement for specific qualifications).

If all of the proposals in the consultation go ahead as anticipated, here are some of the implications and actions.

Implications for Trust Based Pension Plans	Implications for Contract Based Pension Plans
• Quality requirements will be set out in regulations enforced by the Pensions Regulator. • Trustees will need to provide a clear independently audited annual statement that they have met specific governance requirements that will be set out in legislation. • From April 2015, trustees will have duties to consider and report on costs and charges. The Government will subsequently require mandatory, standardised disclosure of all pensions costs and charges in a format that enables comparisons between pension plans. • Cost analysis and disclosure is already covered to a large extent in the DC code of practice and guidance issued by the Pensions Regulator last year (incorporating the 31 Quality Features).	• The Financial Conduct Authority ("FCA") is to consult on rule changes to oversee the quality standards of contract based pension plans. • Pension providers will be required to operate Independent Governance Committees ("IGCs") which will be constituted in line with FCA rules. A key duty of the IGCs will be to assess value for money and compliance with quality standards. The IGCs will make recommendations to providers and will have powers to escalate concerns to members and employers. • From April 2015, IGCs will have duties to consider and report on costs and charges. The Government will subsequently require mandatory, standardised disclosure of all pension costs and charges in a format that enables comparisons between pension plans. • Contract based plans will be required to comply with the same six overarching standards as trust based DC pension plans. • IGCs will have an explicit duty to act in the interests of members – a key change. • Providers will have a duty to ensure the IGC has access to professional advisers who are independent of the provider including an investment adviser and a lawyer.

Speak to your Squire Sanders contact for assistance with any of the following.

Actions for Trust Based Pension Plans	Actions for Contract Based Pension Plans
• Consider responding to the consultation. • Cross-check the new six governance requirements in the light of any action plans already in place to comply with the Pensions Regulator's code of practice. • Develop strategies to engage with members – through conversation, questionnaires, member surveys etc., to demonstrate understanding of the plan's membership profile and the members' attitudes to risk. • Review default investment strategies in the light of member interests and taking into account the legislative relaxations introduced by the 2014 Budget and how this might impact, for example, on lifestyling funds. • Ensure that core pension plan financial transactions are processed promptly and that there is a process in place for monitoring and reporting late payments in line with the Pensions Regulator's code of practice on this issue. • Review the level of charges and the costs incurred in the investment of assets and record conclusions – where necessary consider changing charging structure and investments. • Ensure pension plan records and minutes highlight compliance with the DWP's six governance requirements to aid with future auditing. • Review trustee training records and programmes in order to demonstrate the required competencies.	• Consider responding to the consultation. • Providers must establish processes for setting up IGCs and should consider to what extent they should input into the FCA consultation on IGCs to help to shape workable terms of reference. • The introduction of IGCs is a significant shift in the way in which contract based pension plans are run as there will now be a body in place which has a duty to consider the interests of the member, rather than such plans being run in the commercial interest of the insurers. Insurers will need to consider carefully the membership of IGCs and the identity and qualifications of their independent advisers. • Employers should consider to what extent they may want to have representation on IGCs. • Where employer/member governance committees are already in place it would make sense to start to monitor and run the pension plan in line with the six governance requirements (see action points to left).

Comment

In recent years, many employers may have moved from trust based to contract based pension plans to mitigate not only the burden of guaranteed liabilities, but also the more challenging obligations of running a trust based plan. The recent governance and charges developments in DC pensions bring obligations under contract based FCA governed strands of the DC market closer to the trust based Pensions Regulator regulatory regime. It is regrettable, however, that it does not appear to have been possible for the various regulatory bodies to pull all the quality standards together in one easy to follow piece of guidance.

A real challenge for providers is how to improve governance whilst also containing costs within the 0.75% cap and find a way of providing appropriate "guidance" to the consumer, which dovetails with the obligation in the Budget 2014 reforms to provide "impartial guidance" on retirement choices. Providers will also need to consider how to meet their obligations in respect of trust based plans which act as a wrapper to contract based plans.

A key challenge for the FCA is how to come up with a suitable regulatory framework in respect of cost and charging transparency which can apply across all plans.

Some of the above may be seen as a "politically necessary" tightening up of standards in the DC market in order to encourage increased saving into pension plans and to give consumers confidence that plans will be well run and provide value for money.

This goes hand in hand with the automatic enrolment obligation: if many more employees are to be admitted automatically to pension plans, it follows that those plans ought to meet at least minimum quality assurance standards. The charge cap, the new cost transparencies, and the IGCs all offer the general public something more "tangible" in terms of value and quality – which was arguably needed in order to help restore public confidence after a series of negative news headlines that could have left the average saver feeling that their retirement savings would be better off stored under the mattress.

How all of this will work in practice is a different matter entirely. Improving standards and lowering basic costs is an improvement designed to help increase savings. However, the increased flexibility and choice coming out of the 2014 budget reforms may reduce accumulated income during retirement over the long term. Pensions consultation papers and reforms continue be issued month by month (if not week by week) and we are still waiting to understand and assess the impact of the new IORP proposal and the annuity reform review, both of which will alter again the regulatory framework. The general direction of travel seems to be an improved system for the pensions consumer, but there is still further to go before the route is clear.

Further Information

For further information please contact any of the partners listed, or your usual contact in the Squire Sanders Pensions Team.

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