

There are a growing number of people with Defined Contribution pensions, particularly following the introduction of automatic enrolment in 2012, which has led to a rapidly increasing focus on DC governance over the last few years. Whilst media attention has primarily focussed on the decumulation phase of DC due to the headline grabbing flexibilities being introduced from April 2015, trustees should not overlook the key changes affecting DC accumulation stages from April 2015.

Trustees whose pension plans include an element of DC may be struggling with the weight of the recent legal and regulatory material. In this communication we highlight the new DC legislation applying to trust based pension plans through the introduction of 'The Occupational Pension Schemes (Charges and Governance) Regulations 2015'. These regulations come into force on 6 April 2015.

We look first at the governance measures in Part 1 and then at the charge capping measures in Part 2.

Employers with group personal pensions should note that the Financial Conduct Authority has been working to establish equivalent standards of governance for contract based pensions, also due to come into force from 6 April 2015.

## **Part 1 – The Governance Measures from April 2015**

### **Which Pension Plans are in Scope?**

The governance measures apply to occupational pension plans providing any money purchase benefits. The main exclusions from this are public service plans, unregistered pension arrangements, small self-administered schemes and pension plans that provide no money purchase benefits apart from Additional Voluntary Contribution arrangements. Note that where a pension plan provides money purchase benefits in addition to AVCs, the AVC arrangement does then come within the scope of the governance requirements.

### **Summary of the Key Governance Measures**

#### **1. Costs and charges – good value for members**

Trustees must calculate the charges borne by members and, in so far as they are able to do so, the transaction costs borne by members, and they should assess the extent to which these charges and transaction costs provide good value for members. This requirement applies to all DC funds of pension plans that fall under the scope of the governance measures.

**Failure to comply with the new legal requirements from 6 April 2015 may result in trustee fines.**

#### **2. Default arrangements for governance purposes – members' interests**

Trustees must design default arrangements which are in members' interests and be able to demonstrate that this is the case.

Trustees are required to prepare a written statement of the investment principles governing decisions about the default arrangement. This statement must cover the investment aims, objectives and policies, and include an explanation of how this overall strategy is in the best interests of the relevant members. The default strategy and investment performance should be reviewed at least every three years, or without delay if there is a significant change in investment policy or in membership demographics. In terms of timing, this review could be aligned with the review of the statement of investment principles (but it should be carried out as a separate exercise).

Trustees should note that the definition of a 'default arrangement' for the purposes of the governance regulations may encompass more funds than they would expect – it is not simply the fund to which member contributions are allocated if the member does not make an active choice. Trustees should make an assessment of what constitutes their default arrangement(s) for this purpose – legal advice may be appropriate.

#### **3. Prompt and accurate processing of core financial transactions**

Trustees will be required to ensure that 'core financial transactions' are processed promptly and accurately. A core financial transaction includes (but is not limited to) investment of contributions, payments to or in respect of members and transfers of assets relating to members (whether this is a transfer between investments or a transfer into/out of the plan).

#### **4. Requirement for chair of trustees and the trustees' annual statement**

Trustees must appoint a chair of trustees if there is no existing appointment. The chair will be required to sign off an annual statement certifying that the governance requirements (outlined above) have been met, and describing how the trustee board satisfies the trustee knowledge and understanding requirements. The name of the chair and confirmation that the statement has been produced must be supplied on the scheme return. The chair's statement is required in respect of scheme years ending after 6 April 2015, but where the scheme year ends before 6 July 2015 it should instead be covered in the following year's statement. **An automatic penalty of £500-£2,000 will be issued by the Pensions Regulator for failure to comply with the requirements relating to the chair's statement.**

## 5. Freedom to choose service providers

If the trust deed and rules governing a pension plan contain a provision that restricts the trustees' choice in selecting an adviser or service provider relating to the money purchase benefits in the plan (for example, administration or fund management), that provision will be overridden by regulations. This is to ensure that trustees have freedom to change service providers.

### What Should Trustees Do?

To a large extent, the new governance legislation formalises and builds upon aspects of the Pensions Regulator's existing DC Code of Practice and Guidance<sup>1</sup> that applies to all occupational trust based pension plans providing DC benefits (including AVC arrangements) – so the general concepts of the legislation will already be familiar ground for trustees. The Regulator has also recently issued an [essential guide](#) relating to the new requirements.

Trustees should assess the extra requirements placed upon them by legislation and plan any further action that needs to be taken to comply with the governance legislation, ensuring that all DC funds are considered appropriately.

### A Few Words About 'Master Trusts'

Specific requirements apply to 'relevant multi-employer schemes' which includes master trusts and other pension plans in which employers are not all connected to each other. Relevant multi-employer schemes must comply with additional governance standards including requirements for trustee numbers and trustee independence. The DWP has acknowledged that further assessment needs to be made into the impact of these additional standards on some industry-wide pension plans (mainly ex-public sector plans) and has therefore introduced an exemption for some pension plans established by or under statute, which will apply until April 2016, to allow time for further analysis.

## Part 2 – The Charge Capping Measures

### Which Pension Plans are in Scope?

The charge capping measures apply to the default arrangements of occupational pension plans used as 'qualifying schemes' to satisfy an employer's automatic enrolment duties where those plans offer some money purchase benefits. This does not purely capture pension arrangements into which employees are automatically enrolled, it also includes arrangements that satisfy minimum quality standards (in terms of benefits or contributions) in which employees have continued in membership upon their employer reaching its staging date. This means that trustees of most pension plans will need to assess whether the charge cap applies.

The legislation applies where contributions are made to a default arrangement on or after 6 April 2015 (or the employer's staging date if that is later) and applies to the total funds of a member for as long as he has funds invested in the default arrangement. The charge cap is primarily aimed at protecting members who have made no active choice about their investments.

Small self-administered schemes and pension plans whose only money purchase arrangements are AVCs are amongst those plans that do not fall within the scope of the charge capping requirements. Note that AVCs can be caught by charge capping requirements in pension plans where other money purchase benefits are provided. Default funds that have a 'third party promise' about the level of benefits in place are also excluded – this is narrowly defined and advice should be sought before this exemption is relied upon.

**Note that a default arrangement can be a single fund, or a group of funds chosen by the trustees e.g. a 'lifestyle' investment approach.**

### What are the Key Charge Capping Measures?

#### 1. The level of the cap

The charge cap on affected default arrangements is 0.75% of the member's rights under the arrangement where a single charging structure is in place. Where the charging structure works on a combination basis (e.g. including a flat fee) the trustees need to ensure that the charging structure fits within the limits set out in the legislation.

Trustees must ensure that member borne costs and charges, excluding transaction costs, fall within the cap. In its response to consultation<sup>2</sup>, the DWP has issued a non-exhaustive list of common costs, charges and transactions that it expects to be included or excluded from scope – the legislation is not prescriptive on this issue.

#### 2. Default arrangements for charge capping purposes – not straightforward(!)

Where the charge capping requirements apply to a qualifying scheme, trustees need to identify the default arrangement(s). This will not always be straightforward, especially in multi-employer pension plans, as the assessment needs to be made for each participating employer. A default arrangement is generally understood to be an arrangement to which members' contributions are allocated when they have not made an investment choice, but for the purposes of the charge capping legislation the definition extends further and includes, broadly speaking, funds to which 80% of contributing members have made an active choice to invest (assessed in relation to the workers of each participating employer). This is a simplified explanation – trustees will need to consider how the legislation applies to their own pension plan. Trustees should also note that definition of default arrangement for charge capping purposes differs from the definition used for the new governance measures! Legal advice may be appropriate.

Trustees should ensure that contributions are directed to a default fund that complies with the charge capping measures from 6 April 2015, unless workers have agreed in writing that their contributions should continue to be allocated to an arrangement that does not comply with the charge cap.

The DWP's Charge Cap Guidance<sup>3</sup> contains more information about assessing a default arrangement for charge capping purposes.

<sup>1</sup> [Code of Practice 13](#) – 'Governance and administration of occupational defined contribution trust-based pension schemes, November 2013', and [Regulatory Guidance](#) for defined contribution schemes, April 2014'.

<sup>2</sup> ['Better workplace pensions: Putting savers' interests first'](#), February 2015 (see Annex A for the list of costs, charges and transactions).

<sup>3</sup> ['The charge cap: guidance for trustees and managers of occupational schemes'](#), March 2015.

### 3. Two methods of assessing charge capping

There are two different ways of assessing compliance with charge capping – retrospectively or prospectively but trustees cannot use both systems of assessment in the same charges year. The charges year will be the 12 month period specified in the pension plan documents, or, if no such period is specified, the charges year will commence on 1 April each year unless the trustees decide to adopt 6 April. The charging methods are explained in more detail in the DWP's Charge Cap Guidance .

### 4. Adjustment measures for non-compliant default arrangements

Where trustees find that they cannot comply with the charge cap for a default arrangement they can make use of an 'adjustment measure' as set out in the regulations. This can only be used up to 6 October 2015, unless there are exceptional circumstances. The adjustment measure involves trustees allocating future contributions to a default arrangement which is charge cap compliant or no longer accepting contributions for affected members (which may impact on an employer's compliance with automatic enrolment duties). Members can still remain in the non-compliant arrangement if they agree in writing. If trustees instigate this measure they must give at least one month's notice to the employer, the members and the Pensions Regulator. If the pension plan rules would not allow trustees to take this step, regulations allow trustees to amend the rules by resolution to implement an adjustment measure. Legal advice should be sought.

### 5. Opt-in services – with member agreement

Trustees can offer opt-in services where these are not part of the core service offering and are not required by law (for example, investment advice). Members can enter into a written agreement to pay for opt-in services which result in the level of charges exceeding the cap.

### 6. Active Member Discount ban

The regulations ban the practice of charging more to deferred members than to active members. This will apply to all qualifying schemes for automatic enrolment purposes (not just default funds) from 6 April 2016 and will include money purchase AVC arrangements in DB qualifying schemes. In the meantime, active member discount structures must be taken into account as part of the charge cap limits applying to default arrangements of qualifying schemes from April 2015.

### 7. Compliance and enforcement measures

Trustees will be required to confirm their compliance with the charge cap measures on the scheme return. Failure to comply may result in enforcement action from the Pensions Regulator, including the issue of a compliance notice and ultimately a fine of up to £5,000 for individual trustees and £50,000 for a corporate trustee. Trustees should note that charge cap requirements are in addition to the broader requirements to explain costs and charges and the extent to which these represent good value for money to the members where the pension plan is subject to the governance requirements.

### What Should Trustees Do?

Trustees are advised to make a very thorough assessment of which of their pension plan investments count as default arrangements for the purpose of the charge capping measures, seeking advice as necessary. Not only is charge capping compliance a legal requirement from 6 April 2015, it is also an area that is ripe for future member complaints if trustees fail to identify the appropriate arrangements. Trustees are advised to keep evidence of their work to identify default arrangements, the advice that they receive, and communications with members.

**Trustees should note that they need to comply with charge capping measures from 6 April 2015. Time is short.**

### Developments in 2015

There is more to come in 2015 that will affect DC governance and charging in occupational pension plans. In particular, the DWP has been working with the Financial Conduct Authority and the insurance industry to improve and standardise the information that is made available to trustees on charges and transaction costs. A 'call for evidence' was issued on 2 March 2015 – we can expect to hear more about this in the coming months.

The DWP will also consult on regulations to ban member-borne adviser commission payments in qualifying schemes from April 2016.

### See our checklist overleaf!



## Checklist

Trustees may wish to develop their own checklist for audit purposes, using the following as a start point and adding further actions as appropriate for their pension plan.

### General

Do the trustees have sufficient understanding of the new legislation, or is training required?

### Governance

Is the pension plan within the scope of the DC governance requirements? If yes...

- Has a value for money assessment been undertaken for all DC funds?
- Have the 'default arrangements' for governance purposes been identified?
- Can the trustees demonstrate that the default arrangements are designed in members' interests?
- Have the trustees prepared a written statement of investment principles for the default arrangements? (Remember to plan a review at least every 3 years, or upon a change in investment policy or member demographics.)
- Do the third party administration and investment reports provide enough evidence that core financial transactions are being processed promptly and accurately?
- Has a chair of trustees been appointed?
- Does the pension plan fall within the definition of a 'master trust'? (If so, there are additional requirements.)

### Charge Capping

Are there any default arrangements for charge capping purposes? If yes...

- Have the trustees assessed whether the default arrangements are compliant with the charge capping measures from 6 April 2015?
- If any default arrangement is not compliant from 6 April 2015, has appropriate action been taken (e.g. establishing a new default fund, obtaining member agreement to remaining in a non-compliant fund).
- Have trustees agreed the appropriate one year period for assessing the charge cap? (The 'charges year' will need to be documented.)
- Will charge capping compliance be assessed using the prospective or retrospective method?

### And Finally...

Are the trustees satisfied that they are compliant with the 31 Quality Features identified in the Pensions Regulator's DC Code and Guidance?

## Next Steps

There is undoubtedly a lot for trustees to consider. In terms of both governance measures and charge capping measures the starting point is to identify whether the new legislation applies to any particular pension plan and which funds are affected. From there an action plan can be established. Also, trustees should not forget that the DC Code of Practice and Guidance is still in force and has a wider scope than the legislation.

For further information about any of the issues addressed in this communication please contact any of the partners listed or your usual contact in the Squire Patton Boggs pensions team.

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