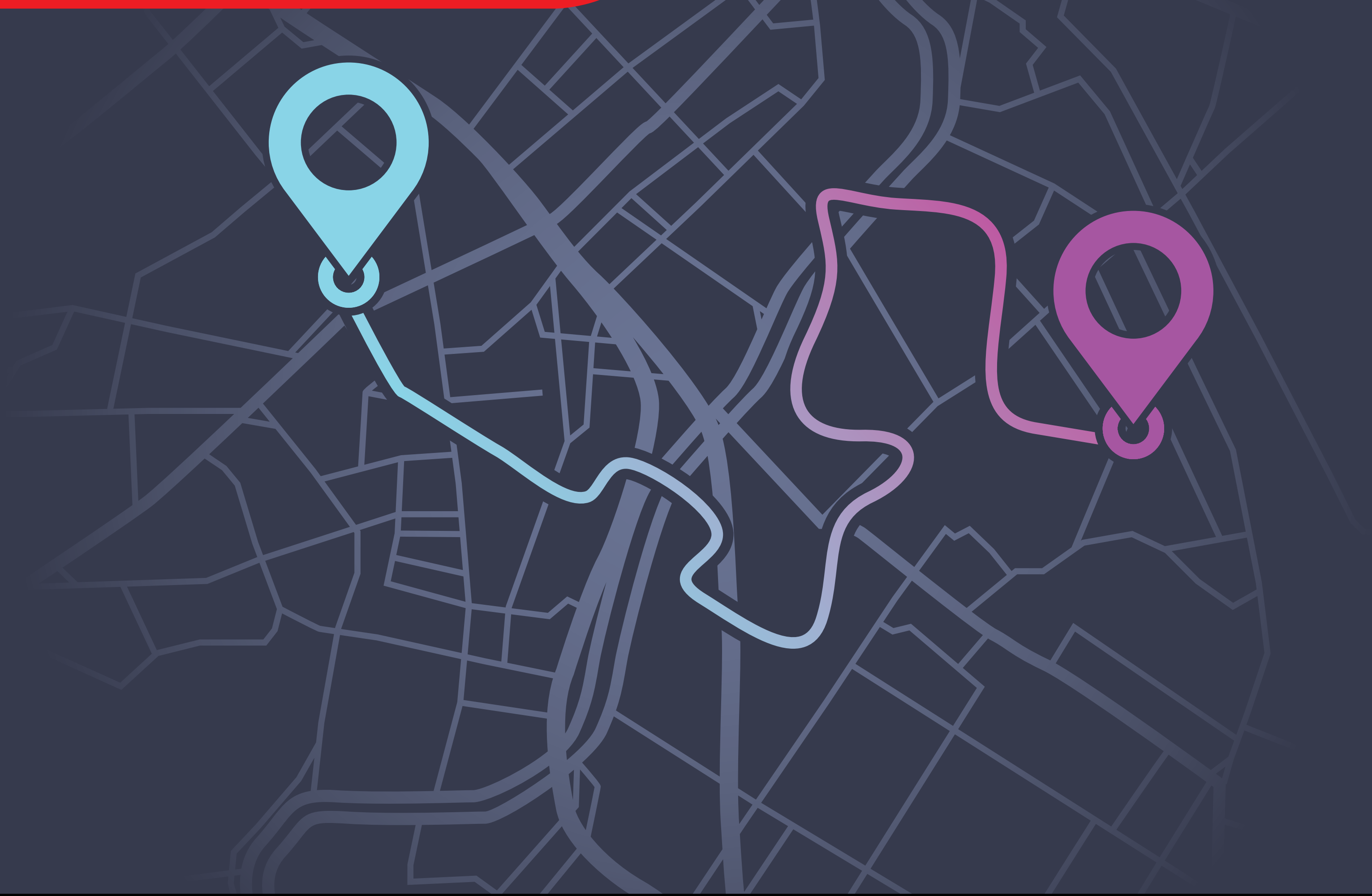
DC Guide 2018:

Navigating changes

Featuring:

- The challenges facing DC scheme trustees
- When trustees should encourage members to make decisions, or lead them into defaults
- Governance best practice
- The increase in master trust regulation



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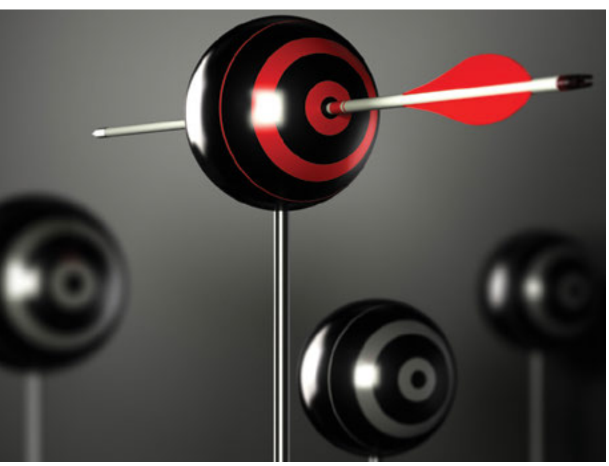
Summary

- A perennial question for DC scheme trustees – how much information needs to be shared and how much does the average scheme member genuinely want to know?
- New rules requiring disclosure of pension scheme investment costs take effect this month.
- The DWP's recent green light for regulations easing the bulk transfer of DC members without their consent is likely to drive scheme consolidation; helping up to one in three of the UK's 2,180 trust-based DC schemes close and transfer members into an arrangement with greater scale.
- Master trusts that don't meet the minimum standards set out in the new authorisation process will need to be wound up in 2019.

Raising the bar

Keeping it simple and straightforward to keep members engaged, while keeping them informed of ever-more complex regulations, is among the many challenges for DC scheme trustees



In the new pension freedoms era, the challenges faced by DC scheme trustees range from effectively communicating and engaging with their members to ensuring they are being offered the best available options for maximising retirement income.

One imminent test will be that of retaining scheme members as two sizeable hikes in auto-enrolment contribution rates kick in. They rise this month from 2 per cent to a minimum of 5 per cent, with employees now contributing 3 per cent of earnings and the employer adding 2 per cent. A further increase, from 5 per cent to 8 per cent, will follow in April 2019 when the employee contribution will be 5 per cent.

"Most scheme trustees I speak to worry most about the issue of member engagement," says Legal & General Investment Management (LGIM) head of DC solutions Emma Douglas. "Auto-enrolment has got many employees into schemes, but has relied too much on apathy and inertia.

"It's admittedly difficult to engage millennials and younger scheme members, who have competing calls on their money, such as paying off student loans and attempting to climb on the housing ladder. However, auto-enrolment does mean that they are saving early on in their careers and contributions are being increased to a more realistic level to ensure they have a decent DC pension pot to look forward to."

For Xafinity Punter Southall head of DC solutions Ken Anderson, the need for scheme flexibility and helping members make sensible decisions are major challenges for those running a DC scheme. He also cites concerns about the efficiency of the independent governance committees (IGCs), whose remit is to represent the interests of members in contract-based rather than trust-based schemes.

In 2015, the Financial Conduct Authority (FCA) stipulated that contract-based pension providers should appoint IGCs to represent scheme members' interests and ensure they get the best possible value for money. However, Anderson says that recent press articles have questioned their performance. Following delays in the FCA's own review, ShareAction recently compiled its own league table ranking the effectiveness of individual IGCs.

The responsible investment charity suggested that many don't adequately report the value for money provided by their respective provider, while its ratings awarded fewer than 10 points out of a maximum of 19 to the majority of IGCs.

Anderson also questions whether changes in regulation are always effectively communicated. "Over the past year, we've been sitting down with clients to ask whether they are keeping scheme members fully up to date with the very latest revisions to auto-enrolment regulation," he says. "The regulator has responded with fines for some schemes that have failed to update members.

"Also is the scheme still fit for purpose? In some cases, investment policy may still be focused on annuity purchase, despite the pension freedom changes introduced three years ago."

Top priorities

Aon's DC investment advisory service leader, Chris Inman, says that the group's most recent employee engagement workshop carried the tagline 'engagement is easy'. It suggested five basic decisions that DC scheme members should consider, based on the changing priorities that will apply at various stages during

their working life and in retirement:
- Should you enrol in the scheme, or leave?
- How much should you contribute?
- Where should you invest?
- What's your planned age of retirement (which will determine an appropriate investment strategy)?
- How will you take your benefits?

Aon has also published the first of three research papers that focuses on defining the stages of a DC member's lifestyle strategy, linking these to investment objectives and reviewing ways of improving the equity allocation for DC savers.

The second and third papers, which appear this month, have as their respective topics the use of diversified growth funds (DGFs) and how to evolve fixed-income investing nearing retirement. "The second paper focuses on whether DGFs still have a place in DC schemes," says Inman.

"We believe they do but clearly defined and realistic objectives need to be set so we don't suffer from the same 'failure of expectations' as has been the case recently. There are many different types of DGF, each with a number of different objectives – performance is just one of them. We found that when each type of DGF is evaluated against its actual risk and return targets, these funds still have a valuable role to play for DC savers."

"Freedom of choice has turned investment on its head," says Douglas. "People often don't know exactly when they'll retire, or what they'll do with their money. The idea of a long, slow slide into retirement and de-risking ahead of it has been replaced by more radical thinking about investment. People tend to invest for longer; indeed their investment should ideally last for as long as possible.

"The recent low-interest rate environment has had the effect of making annuities look particularly poor value and individuals fear being 'ripped off' if they die early. However, higher interest rates could restore to them a measure of attractiveness; particularly for individuals in later life."

Responses to regulation

Royal London head of investment solutions Lorna Blyth reports that the group has made three recent changes in response to scheme member needs and regulation. "The investment default changed in February to target a drawdown outcome," she says. "We've been monitoring customer behaviour since pension freedoms were introduced; initially there was a rush to cash, however over the past year we've seen a steady trend towards drawdown and have changed our default to align with this move.

"We will change all existing schemes in the third quarter this year after writing to advisers, employers and members to explain the shift and give them the option of remaining in their current default which targets annuity."

Royal London is accompanying the change by launching new retirement engagement packs, which will be sent annually to members from five years before their chosen retirement age. "By connecting with members earlier than the government requirement of six months, we believe this will help highlight their choices at retirement and also help align their retirement target with a suitable investment choice," says Blyth.

"The third area is around costs and charges where we have captured and aggregated transaction cost data for members in the default. These have been calculated in line with the FCA template." The group has moved ahead of this month's requirement that all DC scheme trustees publish charge and transaction cost information for investment options in the chair's statement and on a publicly-available website. Disclosure must also include an illustration of the compounding effect of the costs and charges.

Among other changes, the Department for Work and Pensions' (DWP) recent green light for regulations easing the bulk transfer of DC members without their consent is likely to drive scheme consolidation; helping up to one in three of the UK's 2,180 trust-based DC schemes close and transfer members into an arrangement with greater scale.

Regulation is also being introduced for master trusts, which have increased in number since auto-enrolment, with only a handful carrying both the Pensions Quality Mark (PQM) and the Retirement Quality Mark RQM) as well as meeting the master trust assurance framework. DWP plan for a new authorisation process will require master trusts to meet criteria set in five areas.

"The bar could be set fairly high, although as the draft code hasn't yet been issued it's not possible to be certain," says Sackers partner and head of DC Helen Ball. "There will need to be an orderly wind-up process for those master trusts that don't meet the new minimum standards. The law comes into force in October 2018 and trusts have six months in which to make their application, so in 2019 it should be clear which of them doesn't make the grade."

To this already crowded agenda can be added the issue of collective defined contribution (CDC) schemes. This follows the recent agreement between Royal Mail and the Communication Workers Union (CWU) that set a CDC pension benchmark.

"CDCs are likely to be the 'canary in the coalmine'," suggests Inman. "The pooling of assets is certainly a good idea and it will be fantastic if they can make the concept work. But it's unlikely that too many others will be joining Royal Mail until we have a lot more detail."

Written by Graham Buck, a freelance journalist

Decision or default?

Lynda Whitney discusses how and when those managing DC schemes should help members make their own decisions

There are only five decisions a member needs to make about their defined contribution (DC) pension. In this article, we explore whether you should educate the member to make the decision or default them into a scheme solution. By recognising your limited resources, this approach can help you decide where to focus.

The five member decisions

STAY

Employer matching of contributions, along with tax relief, mean it is usually in an employee's best interest to stay in the scheme, unless they are a low earner and struggle to afford contributions, or a high earner if there are Annual Allowance or Lifetime Allowance issues. Your responsibility as an employer is to pick a scheme that offers the best value for your employees; not necessarily the cheapest – but the right balance between cost effectiveness and good service. We can help you benchmark your scheme against more than 300 others with data from Aon's *DC Scheme Survey 2017*.

PAY

The decision on how much to pay in will arguably have the biggest impact, so it is worth investing the time and resources to get this right. Take steps to understand what the typical retirement outcome looks like – is this enough or are changes needed? Educate the member about the benefits of matching (if available), the power of compound returns over time and make it personal by showing them what difference an extra contribution may make. Keep the communications upbeat, as research shows that people take more action in response to aspiration than threats of bad outcomes.

If the employer is really committed to pensions, default members in at the top contribution rate but allow an option to opt-down.

INVEST

Most members do not want to become investment experts. Typically they will follow the scheme default, so spend your time and resources on getting this default right. Keep the other investment choices simple. Where you educate, pick your moments wisely. A member entering a lifestyling phase is more likely to benefit from making a decision about their target outcome.

RETIRE

When a member wants to retire is clearly a personal decision. However, you can help by educating them about what they will get from the state pension and when, as well as from your scheme. The best schemes allow members to picture their future self and to consider what outgoings they might have in retirement. This allows a considered decision about when they might be able to afford to retire comfortably.

SPEND

Whether a member is better off with cash, an annuity or income drawdown will depend on personal circumstances. The scheme needs to educate them about the options available, allowing them to explore areas including tax, inflation, their risk tolerance and whether they need benefits for a dependant. The best tools allow side-by-side comparison of annuities (including reflecting their health conditions) with income drawdown. However, once the member has decided on the shape of the retirement income they want, they often still need help. Schemes can assist by negotiating bulk deals with an independent financial adviser or an income drawdown provider.

So focus your communications strategy – and the precious interest of your members – on the decisions where their input will have the biggest impact. For example what they PAY in, when they want to RETIRE and how they want to SPEND their retirement savings.

For a copy of Aon's latest DC Scheme Survey visit aon.com/dcpensionsuk

Written by Lynda Whitney, partner, Aon

DC governance: Best practice

DC governance should focus on appropriate due diligence to ensure the best chance of delivering optimal outcomes for members. But it's not all about processes; sound governance includes taking practical steps to reduce the risk of adverse outcomes

We focus on four governance factors that we believe are instrumental in helping to deliver your scheme objectives.

Following the DC code

The direction of travel from The Pensions Regulator is clear: higher expectations for trustees and scheme managers are on the way. This is to help support members in a post-freedom and choice world.

The DC code has four key messages for trustees. They must:

1) Act with integrity and competence
2) Act in the interests of scheme members and beneficiaries
3) Be financially sound (professional trustees)
4) Have appropriate levels of knowledge

Value for money is a key area of focus for DC schemes, so how can you ensure this? Of course, it can mean offering low-cost solutions, but it's important to remember that low cost does not always equal good value. From our experience, engaging member communications, high quality service to members and an effective at-retirement solution are now top of the agenda for many trustees and sponsoring employers.

What's your investment strategy?

With continued high numbers of members using default investments, having a default that is appropriate for the majority is crucial in improving overall member outcomes.

A 'default default' that is still popular is one designed to smooth the path towards an annuity purchase. However, this seems at odds with member behaviour, particularly since income drawdown is expected to become the most common method of post-retirement income.

If a scheme offers multiple solutions, some form of guided journey could be offered to help members understand the potential opportunities and risks of each choice. It's also essential that trustees understand member demographics and behaviour, and tailor solutions accordingly.

Questions for discussions with advisers and service providers

In many cases, advisers and providers have been in place for some time, so it's important to evaluate whether they continue to help you meet your objectives.

A good provider should offer value for money, performance that meets agreed targets, engaging communications, funds that meet members' future needs and at-retirement solutions that seek to minimise 'out-of-market' cost and risk.

Where a third-party administrator is in place, it's important to evaluate how adaptable their service is to meet changing member needs. Is pension administration a core part of their business and is there a demonstrable commitment to the DC market?

Where an adviser solution is in place, questions should also focus on conflicts of interest. Ask how the charging structure works and what benefits these bring. Ultimately, if advisers and service providers are not performing as expected, trustees or sponsoring employers should push them to improve the situation as quickly as possible or replace them.

Could delegating the governance be a better solution?

As the immediate challenges of day-to-day governance and administration take centre stage, other initiatives, especially member engagement, can be compromised.

A master trust allows employers to fully outsource the governance, investment and administration of their DC scheme. Not only are the investments designed and managed by experts, but the whole delivery of retirement savings is entrusted to those whose expertise and resources are focused on ensuring the best experience for members and employers. Master trusts also have the benefit of strong, independent governance from designated professional trustees.

Taken together, this can free up resources for other key factors that are crucial in helping to achieve better member outcomes and a better return on investment.

Written by Simon Chinnery, head of DC client solutions and Colin Clarke, head of product policy strategy, LGIM

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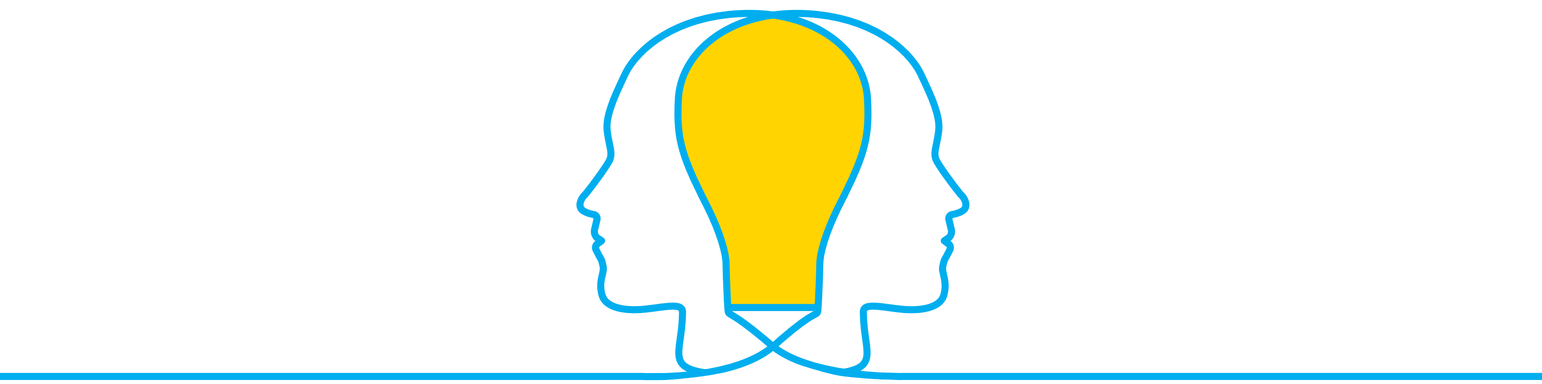
A true meeting of minds. That's how we generate the best ideas for our clients.



We think that the most effective client relationships aren't just based on mutual interest, they're based on a genuinely shared agenda.

Take the example of a major UK pension scheme. The pension fund needed something that could give their members better returns while sheltering them from the long-term financial risks of climate change. Knowing LGIM's values and working practices were aligned with their own they asked us to build a brand new fund to power their pension scheme. So we put our heads together with FTSE Russell and between us we developed the Future World Fund, a ground-breaking, multi-factor fund that tackles climate change risks head on.

By actively engaging with companies who hold the key to a low carbon future and selectively divesting companies that fail to meet the necessary standards, we have created a light bulb product that has the potential to provide thousands of scheme members with a future proofed pension. Why? Because, in all our heads, it's the right thing to do.

lgim.com/futurefund

Master trusts: What next?

Roy Porter looks at the impact of increasing regulation on the master trust market

There's no denying that master trusts have played a crucial role in implementing auto-enrolment, offering real economies of scale and a professional level of governance that would be hard to find cost effectively, had many smaller schemes gone it alone.

Regulation hasn't always kept pace with the level of growth in this sector of the market, but the introduction of the Pensions Schemes Act 2017 changed all of that. Worries about the financial stability of some master trusts, alongside calls from many within the industry itself for more robust regulation, eventually led to the government's decision to introduce a specific authorisation and supervisory regime.

Historically there had been very few quality criteria required to launch a master trust and The Pensions Regulator had few powers to intervene after they had been set up. Whilst the vast majority of people saving in master trusts are doing so with the largest few, this lack of regulation meant some were saving with smaller providers with little or no capital reserves and inadequate business plans.

When the industry is ultimately striving for the best possible retirement outcomes for the greatest number of members, this simply had to change.

From 1 October 2018, there will now be a requirement for master trusts to apply for authorisation to continue operating, which is a welcome move that we'd long lobbied for. Any existing schemes that do not receive authorisation, or fail to comply with the five criteria outlined by The Pension Regulator on an ongoing basis – that the scheme must be run by fit and proper persons; that it must have sufficient and effective system and processes; that it must be financially sustainable; it must have scheme funders who meet specific requirements; and that it must have an adequate continuity strategy – will be required to wind up and transfer their members to another authorised scheme.

The Department for Work and Pensions have just confirmed that existing master trusts will have to pay £41,000 to apply, and any new entrants to the market will be faced with a £23,000 application charge. We are concerned to see that the government is pressing ahead with its proposal to charge different application costs, depending on whether the applicant is an established master trust or a new one. We would argue that the same rigour and assessment needs to be in place on both existing and new master trusts. We would be concerned if this were symptomatic of there being a lower bar in practice for review for new entrants, as, after all, the political impetus behind the Pension Schemes Act was driven by the entrance of low quality, under-capitalised schemes.

There will be a number of hurdles to overcome when applying for authorisation – along with the cost, time, resources required, and the rigorous nature of the authorisation process will force some master trusts to review whether they can continue operating, or whether it makes business sense for them to continue trading.

For those that do decide to cease trading, there are master trusts intending on applying for authorisation this Autumn that are ready to acquire.

At The People's Pension, we recently completed a major master trust merger, in collaboration with JLT Employee Benefits, with around £20 million funds under management transferred to us from Your Workplace Pension master trust, on behalf of almost 9,000 members.

So what does increased regulation mean for the market? Simply put, we expect the rigorous nature of the authorisation regime will naturally create market consolidation, which will leave a smaller number of larger, financially robust master trusts with better governance structures.

Ultimately, proper regulation and authorisation of master trusts will ensure members are appropriately protected, and as an industry, there's no denying that can only be a good thing.

Written by Roy Porter, group director of sales and marketing, The People's Pension

Company Profiles

Aon

Discover better DC built on insight. Aon's expertise in DC pensions is built on our wealth of market data, renowned consultancy services and range of innovative DC solutions. Our dedicated team of DC consultants in the UK form a core part of our retirement business.

We cover DC investments, communications and design, and strongly believe that good governance and improved member outcomes should underpin all aspects of our advice. We think hard about the issues that affect our clients and always use bespoke, highly-appropriate approaches to address them. We recognise the challenge of providing more for your members, while still achieving value for money.

Our technology, products and propositions position us as a leading advisor in the DC market, with over 1,500 DC clients across Aon's businesses. We advise on, design and manage trust-based occupational pension schemes, group personal pension schemes and The Aon MasterTrust, our own master trust solution. So we can offer the complete range of DC services for employers or trustees, helping you find the right solutions to deliver better outcomes for your members.

Aon is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance.

To find out more, please email talktous@aon.com or call us on 0800 279 5588.

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Legal & General Investment Management

Legal & General Investment Management (LGIM) is one of Europe's largest asset managers and a major global investor, with total assets under management of £983.3 billion*. We work with a wide range of global clients, including pension schemes, sovereign wealth funds, fund distributors and retail investors.

Throughout the past 45 years we have built our business through understanding what matters most to our clients and transforming this insight into valuable, accessible investment products and solutions. We provide investment expertise across the full spectrum of asset classes including fixed income, equities, multi-asset, commercial property and cash. Our capabilities range from index-tracking and active strategies to liquidity management and liability-based risk management solutions.

We are one of the world's leading providers of index fund management and a major investor in global fixed income markets. We are at the forefront of developments in liability-driven risk management solutions for defined benefit pension schemes and offer a large variety of strategies to help our clients manage their investment objectives. LGIM is also a leading provider of defined contribution solutions and we continue to innovate as the market evolves, building strong relationships with clients and their consultants.

More than 80% of our new business comes from established clients – a record that demonstrates our belief in growing with our clients and serving them well. Industry-leading client service means being accessible and delivering investment expertise consistently. Whether that means reliably providing a market return through our index funds, or establishing a bespoke actively managed solution that fits a client's needs, we have one key focus – to provide what our clients tell us they need most.

**as at 31 December 2017, including derivative positions. These figures include assets managed by LGIMA, an SEC Registered Investment Advisor.*

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The People's Pension

The People's Pension is the UK's largest private sector DC master trust with more than 3.5 million members and over 70,000 employers of all sizes from a wide variety of sectors signed up. It's a flexible and portable workplace pension, designed for people, not profit. With no shareholders, any surpluses are used for the benefit of our members.

Run by not-for-profit provider B&CE, which recently celebrated its 75th year, our values of creating simplicity, showing compassion and keeping promises drive everything we do.

The People's Pension is a multi-employer scheme with independent trustees and it's a hassle-free, flexible and portable workplace pension suitable for any organisation, large or small, in any sector.

Pension Quality Mark (PQM) READY is designed to help employers identify a good multi-employer pension scheme or master trust and aims to promote best practice around charges and scheme governance.

The People's Pension has gained the PQM READY standard in recognition of its low charges, clear communications and strong governance.

The People's Pension was the first master trust to report on its governance and administration arrangements in accordance with the Institute of Chartered Accountants of England and Wales' (ICAEW) new assurance framework for master trusts.

Earlier this year, we also led the way in public disclosure of the underlying transaction costs of our investment funds. Transparency in transaction costs is crucial in helping consumers assess value for money, and it's important to us that this information is scrutinised as part of effective scheme governance.

And we're striving to achieve excellence in our communications. We've become a corporate member of the Plain Language Commission and are extremely pleased that some of our member and employer facing publications have achieved their Clear English Standard accreditation. We pride ourselves on the simple, stripped back language we use to communicate to our clients and members – pensions shouldn't be complicated.

Pensions Age

Pensions Age is the leading title targeting UK pension funds and their consultants. Published monthly in print since 1996, and daily online, we invest heavily in our circulation and content to ensure we are the clear market leading title. Our in-house editorial team of Francesca Fabrizi (Editor in Chief), Laura Blows (Editor), Natalie Tuck (News Editor) Talya Misiri (Senior Reporter) and Theo Andrew (Reporter) ensure we cover the latest news and topical industry issues to help our readers make the best informed decisions.

www.pensionsage.com is the leading website for pension funds, and we look to cover the breaking stories as they happen. With over 24,000 subscribers to our email newsletter service; we offer our readers an unrivalled service. At the core of this is high quality, news-breaking journalism combined with in-depth knowledge of the target market and heavy research into data.

Pensions Age also runs highly successful conferences, and the Pensions Age Awards.

We also publish *European Pensions*, which targets pensions funds across Europe, as well as running the European Pensions Awards, Irish Pensions Awards, and Pensioni & Welfare Italia Awards. We also run an Italian language e-newsletter and website, and run an annual Nordics roundtable.