Governing contracts

With the roll-out of auto-enrolment, greater numbers of the population have taken to saving through contract-based pension schemes. Talya Misiri looks at how these schemes have evolved

With the roll-out of auto-enrolment in full swing, greater numbers of the population have taken to saving through contract-based workplace pensions. Because of this, the structure of contract-based schemes has evolved in the last few years.

Commenting on the changing nature of these schemes, Standard Life head of pensions strategy Jamie Jenkins highlights that: "Contract-based pensions are very similar now to their trust-based counterparts. Following simplification in 2006, many of the legal differences in benefits and allowances were removed and, more recently, automatic enrolment has brought the two even closer in terms of how they are used for workplace retirement saving."

According to the most recent figures from the Financial Conduct Authority and The Pensions Regulator, the size of assets held or invested in contract-based defined contribution workplace pensions totals £168 billion.

With this upsurge in contract-based schemes, the pensions industry largely agrees that cost regulation and governance has become increasingly important.

Independent governance committees, which were introduced by the FCA for this type of scheme in 2015 to take on a similar role to trustees, are "championing value for money for customers and demonstrating more transparency in the world of contract-based providers," Aegon head of pensions Kate Smith says.

"While contract-based pensions usually don't have trustees, most of them now benefit from independent governance committees (IGCs), whose duties are similar in focusing on value for money and good member outcomes," Jenkins agrees.

In addition, the FCA's most recent *Sector Views* paper states that: "When it comes to costs, the data shows that the charge cap and the work done by providers' independent governance committees have been effective at controlling costs in the workplace pensions market."

Smith shares a similar view that although "IGCs have only been in place for three years, they are already working very effectively". She explains that regulating contract-based schemes in this way has aided in bridging the gap regarding "providers' responsibility to look out for the interest of consumers, a strength of occupational pension schemes".

With this regulatory success, Smith continues to suggest that contract-based and occupational pension schemes "can learn from each other" as IGCs have "strengthened" contract-based schemes.

Moreover, the upcoming General Data Protection Regulation, to be introduced on 25 May this year, is also an area that contract-based schemes need to be fully prepared for, says Stevens & Bolton law firm partner Gabrielle Holgate.

"Top of the agenda…is handling the implications of the GDPR", she notes, adding that schemes will need to review their contracts with suppliers such as actuaries and administrators. In addition, these schemes will need to allocate communications to members and put "appropriate data protection policies" in place.

It appears however, that there is still a "marginal difference in the balance of power *[between contract and trust-based schemes]* when it comes to dealing with changes and updates," Jenkins says. He highlights that for trust-based schemes, "trustees can usually make changes for multiple members if they feel it is in their interests," whereas for contract-based schemes it is essential that the individual consent of members is gained before any widespread changes are made.

Holgate also mentions that, added to this, The Pensions Regulator's recently issued guidance on cybersecurity is an area that schemes will need to "focus on more closely" in order to ensure that members' data is protected.

Written by Talya Misiri

Heavy shoulders

It appears that change for the better in the trust-based pensions landscape is in sight. With clearer guidelines from The Pensions Regulator on scheme valuations and risk management, IRM policies, de-risking and scheme transfers, the market is evolving at a dizzying pace

Change in the trust-based pensions landscape is taking place at a dizzying pace. With clearer guidelines from The Pensions Regulator on scheme valuations and risk management, and improved scheme funding levels, these schemes seem to be in a stronger position to secure better member outcomes.

Commenting on the current climate, Willis Towers Watson head of trustee clients Peter Routledge notes: "After a lost decade of seemingly bottomless deficits and funding, levels appear to be improving. This is against the unpromising backdrop of schemes maturing and press coverage of high-profile corporate failures."

TPR's recently published annual statement reiterated that trustees and sponsoring employers of defined benefit schemes must do more to protect members' benefits. For companies in a weaker position, TPR highlighted that pension scheme liabilities should take greater priority than shareholder returns.

"The latest from the Pensions Regulator, namely its annual statement, should be high on trustees' agendas. This state of union address is a trove of information and informs how trustees should be thinking about their schemes in order that they might meet the regulator's expectations," Broadstone technical director David Brooks says.

With this, Brooks notes that the statement is also a "timely reminder to ensure that good progress has been made on integrated risk management (IRM)."

This area, Brooks says, is "crucial in informing trustees on how they should be assessing and controlling the risks in their schemes."

However, Lincoln Pensions managing director Alex Hutton-Mills states: "Many schemes are struggling to implement IRM into practice effectively." This, he notes, is due to the fact that these schemes "lack the time and resources to develop their approach, or because there has been limited practical guidance on how trustees can link covenant and their investment and funding strategies".

Nonetheless, while "adopting a more joined-up mindset when addressing risk can be quite a challenge, for those that are able to crack that nut, the benefits can be manifold," Hutton-Mills says.

To further hedge the risks facing these schemes, some trustees are considering their insurance options. Routledge comments: "Many schemes are considering whether now is a good time to buy-in or commit to a run-off strategy. For some schemes the stars have aligned to let them lock in to a higher funding level than they expected while taking risk off the table.

He also mentions that the industry is also experiencing "higher than usual transfer activity". With the pension freedoms reform, greater numbers of DB members are keen to transfer to DC schemes to utilise their decumulation options.

In the past few years, it has been estimated that around 200,000 DB members have transferred out into a DC scheme, with thousands more expected to follow.

Royal London director of policy Steve Webb notes that despite the fact that "it is certainly true that regulators continue to take the view that staying in a DB scheme will be the right answer for most," trustees must act in the best interests of their members to enable them to make sustainable choices.

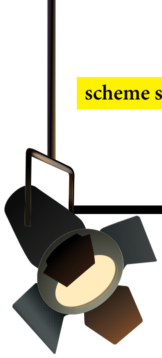
"In my view, if trustees want to act in the best interests of their members they should be supporting them in accessing impartial financial advice, and ideally contributing to the cost. That way, each individual member can secure the outcome that is right in their unique circumstances," Webb advises.

In order to ensure the overall and continued success of trust-based schemes, however, TPR highlights that good governance is key. A spokesperson for the regulator details that through its 21st Century Trusteeship agenda, it is looking to drive up standards in the sector. "We want to see those running pension schemes being a knowledgeable, empowered first line of defence for scheme members. We are making our expectations clearer, taking action against poor governance and encouraging consolidation where appropriate.

"Good governance is the bedrock of a well-run scheme and is key for trustees to achieve good member outcomes."

Brooks concludes: "There is a lot on the trustees' plate at the moment and it must feel like shifting sands with more change coming. I would urge trustees to play the cards they are dealt and not worry unduly about the way the regulations and the regulator may change until we know more. Of course this is easier said than done."

Written by Talya Misiri



Mastering the market

Talya Misiri looks at how the master trust market is set to evolve, the impact of more stringent regulations, protecting member interests and innovation in the decumulation market

Master trusts have grown to represent over 35 per cent of the workplace pensions market and account for the savings of more than seven million defined contribution members in the UK.

"Once a small part of the pensions industry, master trusts have become a force to be reckoned with," Now: Pensions interim CEO Troy Clutterbuck notes.

With the multi-employer savings part of the DC pensions market rapidly evolving and growing in number, it has been decided that more stringent rules are required to ensure master trusts are effectively regulated.

"With seven million savers to look after, tightening regulation and supervision of the master trust sector is vital and well overdue," says Clutterbuck.

Earlier this year, The Pensions Regulator launched for consultation its code of practice for master trust authorisation, which ran until 8 May 2018. The consultation outlines what is expected of master trusts applying for authorisation, and confirms that new schemes will be subject to tighter supervision once authorised.

TPR acting director of regulatory policy Anthony Raymond explains: "As the master-trust market grew we had concerns about the lack of regulation for these schemes and so we lobbied the government for stricter rules.

"The publication of our code of practice marks another important step towards establishing a market with stronger safeguards and which pension savers can have confidence in."

Furthermore, the government is to introduce a two-tiered fee structure for schemes applying to become master trusts, it has said.

While regulation of these schemes is necessary, Clutterbuck argues that: "One side effect of enhanced regulation could be consolidation in the sector."

JLT Employee Benefits head of technical John Wilson agrees: "Recent developments, such as the Pension Schemes Act 2017, introducing an authorisation and supervision regime for master trusts, are however, expected to lead to some consolidation."

Nonetheless, Clutterbuck states that: "Trusts with less sustainable business models may choose to exit, or find themselves under huge pressure to exit because of the burden imposed by the new reigime."

"While this is not necessarily a bad thing, any consolidation needs to be well managed so savers remain fully protected,."

Also considering member interests, a recent report by Hymans Robertson found that only three of the UK's top 17 master trusts offer pensions tax relief to their lowest-paid members. Hymans Robertson head of scheme design and provider evaluation, Jesal Mistry highlights the fact that only three schemes surveyed offer tax relief at source is "not just surprising but a major concern as it could mean thousands of auto-enrolled individuals are not receiving the tax relief they were promised".

Aon senior partner Kevin Wesbroom suggests: "One 'easy' way for HMRC to solve the dilemma between low earners (who are better suited to RAS) and higher earners (better suited to net pay) is to move everybody to a RAS basis – forcing millions to complete tax returns to claim their higher rate relief. The danger is that HMRC decide to simplify the RAS process by just abandoning the reclaim of higher rate relief."

Moreover, both Wilson and Nest Insight executive director Will Sandbrook share the view that master trusts have the potential to shape pensions decumulation options. Wilson comments: "Master trusts will remain a prominent feature of the DC pensions landscape and they are well placed to take the lead when it comes to innovation in areas such as decumulation."

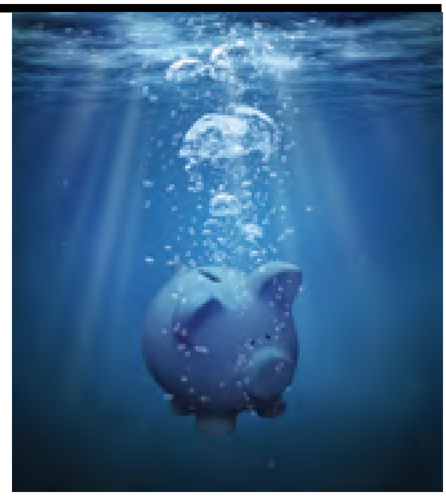
He explains that innovation in the space will be "welcome" as the pensions decumulation market on the DC side continues to evolve in response to the freedom and choice reforms.

Alongside the Aspen Institute, Nest has also proposed a new hybrid approach to workplace pensions and savings in the form of a sidecar savings account. This would involve the dividing of pension contributions into the locked retirement savings account and a 'rainy-day' account for members, the scheme has explained.

Sandbrook outlines that hybrid products like this "could offer a solution by creating an optimal balance of liquid and illiquid savings for each saver. By volunteering to contribute over and above the minimum level set for auto-enrolment, this approach would allow a worker's pension pot to remain locked up, and invested for the long term, while creating an emergency buffer of liquid savings to help them build short-term resilience".

Written by Talya Misiri

Murky waters



At a time of increasing change for personal pensions, Talya Misiri questions what the current climate and future holds for SIPPs and SASSs

With the personal pension market being thrust under the microscope in the past 12 months, increasing levels of uncertainty has clouded the market.

Considering the current personal pensions climate, Xafinity SIPP & SSAS director of self invested pensions Andy Bowsher states: "Cloudy, definitely some dark clouds, and yes, the odd crack of distant 'toxic asset/class action' thunder."

More specifically, many industry commentators have highlighted the potential effect that ongoing court cases could have to the personal pensions sector as a whole. Both Dentons Pension Management director of technical services Martin Tilley and Bowsher agree that the impact could be significant.

Cases that are currently undergoing scrutiny include the investigation of personal pension provider Sippchoice regarding in-specie contributions, which is awaiting HMRC verdict; Carey Pensions SIPP misselling and allegations against provider Berkeley Burke for investments in risky schemes and the losses incurred from these.

Tilley notes: "There is a high expectation the SIPP market will change dramatically over the year, with the pending court case results having a huge impact on the whole industry. It is clear that not only are regulators cracking down on the use of non-regulated intermediaries, it is also being widely criticised by the industry."

Bowsher adds: "There are legal cases underway against certain SIPP providers, the results of which could be seminal moments for the industry." If providers are found guilty of allowing non-advised assets that are inappropriate for SIPPs, "the fall out could be serious", he notes.

"FCA statements in those legal cases, coupled with the FSCS approach to certain assets are no doubt adding to the pressures being faced by SIPP providers."

Change is also occurring among personal pension providers, with predictions that the market could see an uplift in consolidation.

According to a recent survey by Dentons, 85 per cent of advisers say they believe the number of SIPP operators in the market will contract. Tilley comments: "The results of the survey show that there is a high expectation the SIPP market will change dramatically over the year."

Dentons notes that advisers believe that the personal pensions market is due to contract, with a potential five or more providers being consolidated.

Nonetheless, as flexible pension products, SIPPs are still increasingly "well placed to play a key role in the post pension freedoms retirement market," says Curtis Banks pension technical manager Jessica List.

With £403 billion assets held or invested in personal pensions savings market, as noted by the Financial Conduct Authority's most recent *Sector Views 2018* publication, a wide range of investment options are available to members.

"SIPPs are most likely to offer the widest range of investment choices for people whose pension funds may now stay invested long past their retirement," List adds.

This has created an environment where SIPPs are "more popular than ever," List opines, although as a result of this increase in uptake, advisers and providers are expected to be more cautious, "using increased due diligence checks to help protect clients," she says.

However, Tilley comments: "There is a belief that SIPP providers will have to take more responsibility for the investments being made by clients, especially where they are deemed to be 'high risk'. To support this, SIPP providers are going to need to invest in more resources, which will in turn increase costs and this is something not all providers will have the capability to absorb.

"Therefore, it is possible we could see more consolidation in the market or for those whom it is not core to their business, stepping away from SIPPs altogether."

Considering the future of personal pension products, Dentons director of sales and marketing David Fox summarises: "With a number of regulatory changes being put in place causing added pressures, there has been a level of uncertainty for a number of SIPP operators. We do not believe this is likely to change in the near future and we will continue to face challenges throughout 2018."

Bowsher concludes: "The clouds may pass, or it may pour."

Written by Talya Misiri