

## DC update

An update on progress with our commitments in relation to work-based DC schemes plus results of extensive independent research

**January 2008**

[www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk)

## Key points

- This update relates to work-based **DC schemes**, which includes trust-based schemes, contract-based group personal pensions with a direct payment arrangement and stakeholder pension schemes.
- It sets out how we're delivering on our commitments with regard to work-based DC schemes along with our plans for issuing further guidance, good practice examples and case studies.
- It will be of interest to trustees and employers and also to their advisers and others, such as third-party administrators and group personal pension (GPP) providers, with responsibility for administering and running DC schemes.
- It includes the results of extensive independent research into the operation of work-based DC schemes conducted on our behalf by Harris Interactive.

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## The Pensions Regulator's approach to DC regulation

The Pensions Regulator's aim on work-based DC (money purchase) schemes is to use its approach of education and enablement to reduce the risks to members' benefits and promote and improve understanding of good administration.

We will consider using our powers to intervene where there are potential fraud implications, or, as a last resort, where other attempts to get the situation rectified have failed.

We have a statutory responsibility in relation to work-based pension schemes. These include occupational pension schemes, personal pension schemes where direct payment arrangements exist in respect of one or more members of the scheme and stakeholder pension schemes.

Two of the regulator's statutory objectives in relation to these schemes are:

- to protect members' benefits; and
- to promote and to improve understanding of good administration.

We have identified the main risk areas appropriate for the regulator to focus on, namely:

- lack of member understanding;
- poor administrative practices;
- poor investment practices;
- unduly high charges; and
- poor decisions on retirement choices.

In order to mitigate these risks and to help people take opportunities to build on existing good practice, we are adopting a three-pronged approach:

- providing education and guidance;
- working in partnership; and
- intervention, proportionate to the level of risk.

Details of our consultation exercise including the consultation report – *How the Pensions Regulator will regulate defined contribution schemes in relation to risks to members* – are available on our website under 'Online publications / Policy documents'.

We are part way through our programme focusing on our objective to protect members' benefits in DC schemes and to promote and improve understanding of good administration. Although we have made a start, we recognise there is still a good deal to do. We undertook to update our stakeholders as progress was made. Below is a summary of our objectives so far, involving consultation, workshops, surveys, other research and publications.

Our website will be updated periodically with new information and guidance on work-based DC schemes.

## Summary of progress on DC

### Research and surveys

The Pensions Regulator is an evidence-based regulator and hence research into the experience of trustees and others running DC arrangements is central to achieving our statutory objectives of protecting members' benefits and promoting good administration.

This evidence base includes our **analysis of information** available to our stakeholders on the web. We are using this, together with the results of other research, to make decisions on where additional guidance may be needed and where links to other websites may be useful.

Our growing evidence base is also now underpinned by:

- **in-depth qualitative research** into work-based DC schemes carried out on our behalf by an independent agency (see the 'Research results' section of this document, or our website under 'Online publications / Facts and figures'); and
- analysis of the **DC scheme returns** and information amassed from surveys conducted by other organisations (see 'The occupational DC landscape' section of this document, or our website: 'Online publications / Facts and figures').

### Consultation and workshops

In our consultation report, we emphasised the importance of working in partnership with other organisations in order to ensure that initiatives to address DC risks can be put into practice effectively and proportionately.

Accordingly, we have:

- **worked closely with the Financial Services Authority (FSA)**, establishing an ongoing series of bi-partite meetings and we have updated and extended the **memorandum of understanding** between our two organisations (see our website: Online publications / Corporate documents);
- continued working with the **DC consultation working group**. Members of this group, together with other volunteers from within the pensions industry have attended two workshops held in July and September 2007. We used the workshops to consult on possible approaches to the provision of education and guidance in a number of areas. We shared draft guidance with participants and a number of participants contributed examples of good practice which we will use to inform our work; and
- participated in the **Open Market Option Review Working Group** investigation into exercise of the open market option led by the Department for Work and Pensions (DWP) and HM Treasury and we are working with the FSA, the Pensions Advisory Service (TPAS) and with the DWP to help deliver the measures put forward in the Pre-Budget Report (see the HM Treasury website: [http://www.hm-treasury.gov.uk/media/7/5/pbr\\_csr07\\_omo74.pdf](http://www.hm-treasury.gov.uk/media/7/5/pbr_csr07_omo74.pdf)).

## Guidance, TKU and publications

The following guidance is now available on our website:

- Guidance on *Voluntary employer engagement in work place contract-based pension schemes*, published simultaneously with this Update (from the homepage, follow the link to 'Information for employers'). In producing this guidance, we consulted extensively on the use of management committees and other groups. This included teleconferences with providers, independent financial advisers and employers. We also consulted industry representative bodies and other government bodies.
- We have issued a module as part of the Trustee toolkit: **How a DC scheme works** and other modules which include informative training for trustees on DC governance.
- We have published, jointly with the FSA, a *Guide to the regulation of work place contract-based pensions*, available on our website: Online publications / Policy documents.

## Soon to be available on DC

Our next steps are to develop further guidance on the key areas of member understanding, investments, retirement choices and administration that will help people build on existing good practice.

We will be issuing:

- **guidance, good practice examples and case studies** to promote the value of good member communication;
- **good practice examples** in relation to the operation of the retirement options in trust-based DC schemes; and
- **guidance on investment**, specifically covering:
  - the matters that need to be considered when appointing an investment manager, choosing a provider or selecting funds;
  - sample wording for trustees to help them explain issues relating to fund choice; and
  - the importance of obtaining 'value for money'.

In addition, over the coming months, we will:

- continue to update our website; in particular we will include information about the **risks to members** in DC schemes, **questions and answers** and **signposting** of relevant guidance from other websites;
- continue to consider with others how **standards of administration** on DC schemes may be raised;
- analyse and report on information contained in future DC scheme returns; and
- issue supplementary e-learning for trustees in relation to winding up trust-based DC schemes.

## Our growing DC evidence base

Besides making use of research that is available to us from outside sources, the regulator commissions its own primary research.

An independent study conducted for the regulator by Harris Interactive provides an in-depth analysis of work-based DC (money purchase) schemes. The results provide information about how different types of work-based DC scheme are run, illustrating the challenges they present and providing valuable insight into the steps that are already being taken by trustees, employers, providers, independent financial advisers (IFAs) and administrators to help mitigate the risks.

For more about the Harris Interactive DC qualitative research, read the **Research results** section of this document. You'll also find a summary of the methodology used in carrying out the DC risks qualitative research.

The regulator collects data from scheme returns and registrations which allows it to compile a unique data source relating to occupational DC schemes in the UK.

For more about the data obtained from an analysis of DC scheme returns and the scheme register, read the **Occupational DC landscape** section of this document. The section also includes a summary of our methodology for the use of data from DC returns and the scheme register.

## The occupational DC landscape

We have a statutory responsibility in relation to work-based pension schemes. These include occupational pension schemes, personal pension schemes where direct payment arrangements exist in respect of one or more members of the scheme and stakeholder pension schemes.

This section contains data on **occupational schemes** gathered from scheme returns and scheme registrations.

In the occupational DC landscape pages, a 'DC only scheme' is a trust-based occupational pension scheme in which all benefits are provided on a defined contribution basis.

A 'hybrid scheme' is a sectionalised scheme where one or more sections of the scheme provide benefits in relation to ordinary contributions (not additional voluntary contributions) on a DC basis and where one or more sections provide benefits on some other (non-DC) basis.

You may want to refer to the summary of the methodology used in relation to data drawn from scheme returns at the end of this document.

The DC landscape is changing; for example, it will be affected by government plans to introduce personal accounts with the prospect of auto-enrolment for work-based schemes that are to be used as qualifying schemes.

We'll update our DC information once we have analysed the next group of scheme returns sent out for completion in December 2007 and early 2008.

### Key points from The occupational DC landscape data analysis

- Three quarters of DC only schemes have fewer than five members
- Around half of DC only/hybrid scheme members are deferred members
- There are around £160 billion of assets in DC only schemes, based on extrapolated data
- Members of 2 to 4 member DC only/hybrid schemes hold the vast majority of the total assets in these types of schemes, based on extrapolated data

## Number of DC only and hybrid schemes in the UK

Number of scheme members	Number of hybrid schemes	Number of DC only schemes	Total
2 to 4	643	60,271	60,914
5 to 99	392	12,292	12,684
100 to 999	677	1,397	2,074
1,000 to 4,999	328	178	506
5,000 to 9,999	84	29	113
10,000 plus	101	15	116
Unknown	24	6,694	6,718
<b>Total</b>	<b>2,249</b>	<b>80,876</b>	<b>83,125</b>

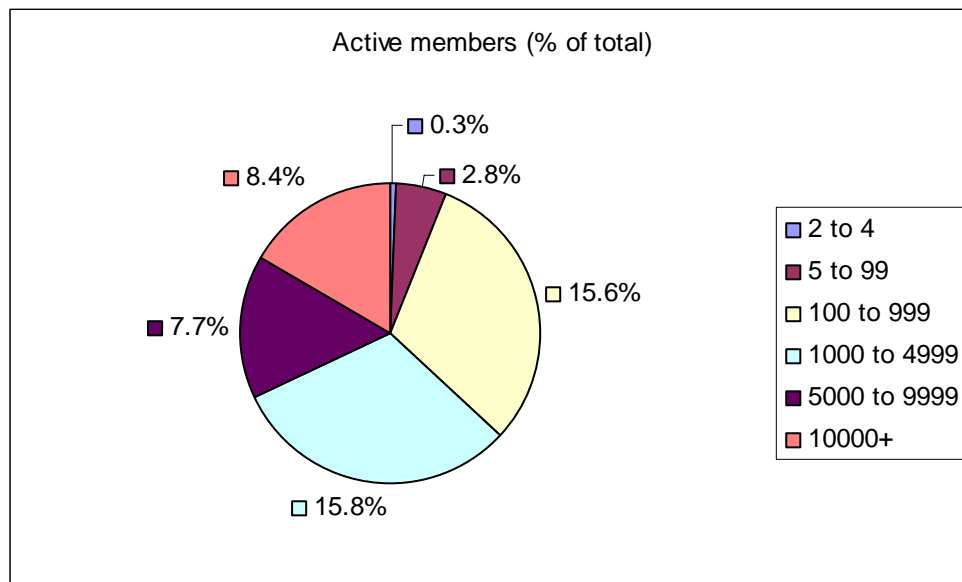
Derived from the regulator's register of occupational pension schemes as at March 2007. Includes schemes winding up. Excludes schemes with only one member.

### Key point:

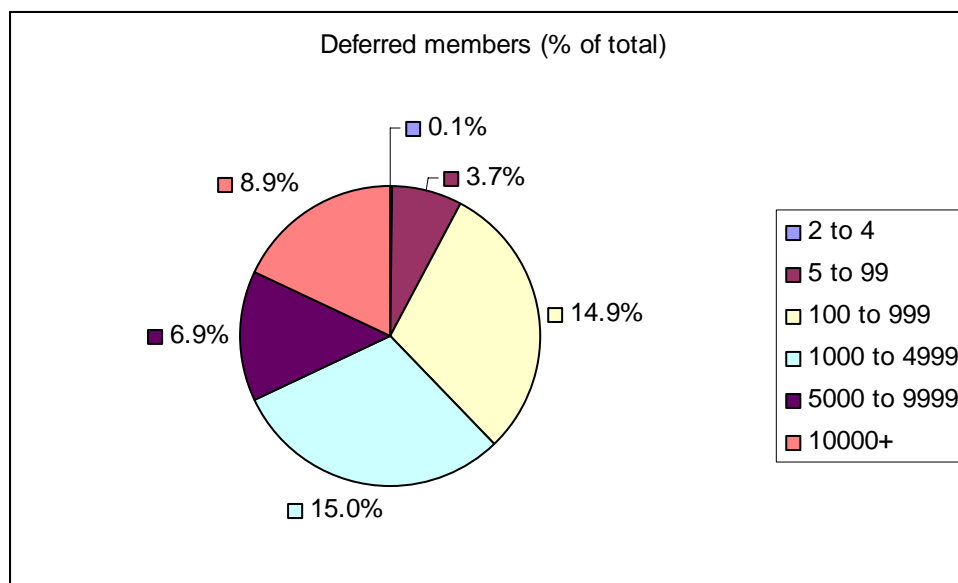
As the chart above shows, of the 80,876 DC only schemes registered with the regulator, three quarters have fewer than five members.

### Active and deferred members in DC only and hybrid schemes in scheme returns received by June 2007

On scheme returns, trustees are asked to provide the number of active and deferred members (these terms were not defined on the scheme return form and therefore we do not define them here).



Total active members: 50.6% of total active and deferred members



Total deferred members: 49.4% of total active and deferred members

**Key point:**

These tables show that only around half of the membership of DC only and hybrid schemes are active.

**Assets in DC only schemes – extrapolated from scheme returns received by June 2007**

Number of scheme members	Extrapolated assets in DC only schemes (£m)
2 to 4	120,870
5 to 99	10,075
100 to 999	9,090
1000 to 4999	5,256
5000 to 9999	1,593
10000+	12,671
<b>Total</b>	<b>159,555</b>

To obtain an idea of the amount of assets held in DC only schemes, we have taken the amount of assets held by members of DC only schemes for which we have scheme returns, broken down by scheme size. We have extrapolated from these figures by calculating the average assets held by each member grouping, and then multiplying this by the total number of members in each group.

**Key points – based on extrapolated assets:**

Based on our extrapolation, there appear to be around £160 billion of assets in DC only schemes.

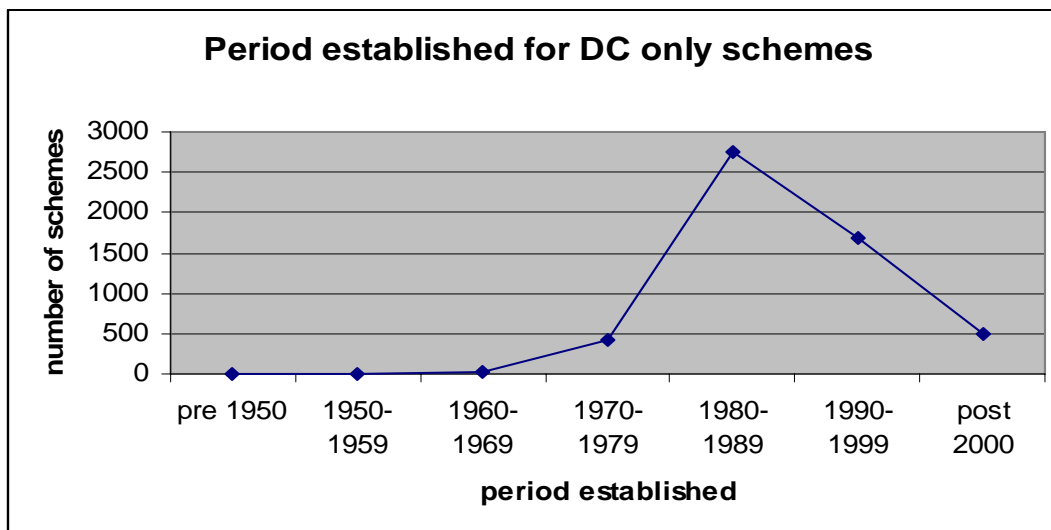
Based on our extrapolation, there appear to be more assets in the group of schemes with 2 to 4 members than in other member groupings.

**Type of administration for DC and hybrid schemes – based on scheme returns received by June 2007**

The vast majority of DC only and hybrid schemes outsource their administration, either to a third-party administrator (TPA) or to a pension provider. For DC schemes, approximately equal numbers of schemes use a TPA as use a provider; whereas for hybrid schemes the majority (around 5 to 1) use a TPA.

Within our sample, 20 TPAs and pension providers service approximately 65% of the outsourced administration market.

**Period established for DC only schemes – based on scheme returns received by June 2007**



The vast majority of DC only schemes for which we received scheme returns by June 2007 were set up between 1980 and 1999. There has been a slowdown in the growth of DC only schemes. This can be seen in the above graph, which peaks in the 1980-89 period, after which it dips, corresponding to the time when group personal pensions (GPPs) were introduced and employers had the alternative of making a GPP available.

## Research results

The information which follows is drawn from an independent qualitative study conducted for the regulator by Harris Interactive. We already conduct an annual governance survey which provides quantitative data about how DC schemes are run, including some information about the overall governance of DC schemes.

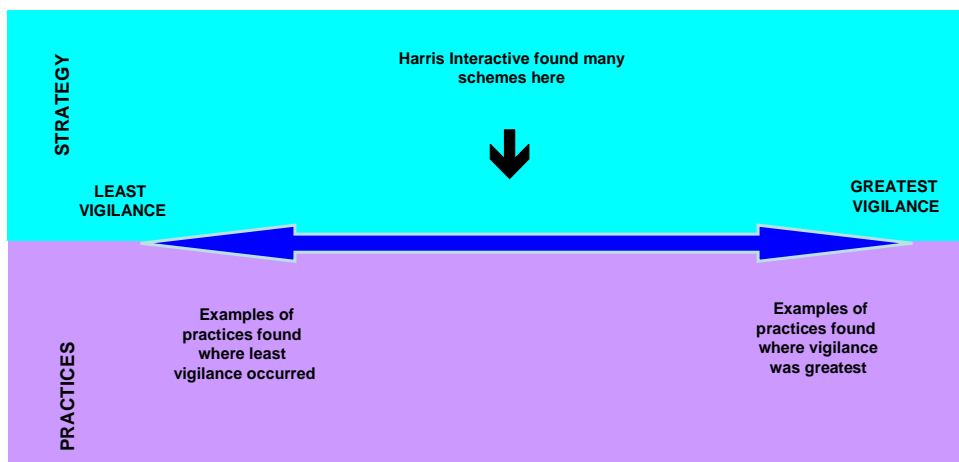
You can read the report – *Occupational pension scheme governance survey* – on our website in the 'Online publications' section, following the link to 'Facts and figures'.

This new research, by Harris Interactive, which was conducted in August and September 2007, was commissioned with the purpose of obtaining in-depth qualitative information about how DC schemes are run. The result is a robust exploration of the subject matter, for which respondents were engaged to talk for up to one hour about a scheme with which they are involved.

In total, 64 interviews were conducted covering contract-based schemes (GPPs and stakeholders) and trust-based schemes (DC only, hybrid (having a DC section in a mixed arrangement) and additional voluntary contributions (AVCs) to defined benefit schemes). Respondents included providers (12), administrators (8), trustees (5), employers (27) and advisers (12). We also ensured that schemes of different sizes were included.

Diagrams (see Figure 1) illustrate Harris Interactive's assessment of current practice based on all of the interviews. The descriptors at either end of the scale (below the arrows) provide examples of practice Harris Interactive identified as most likely to occur in schemes that they considered to be least vigilant (on the left hand side) or most vigilant (on the right hand side). The arrow indicates the position on the scale where, in the researcher's judgment, the greatest number of schemes was found.

**Fig 1. Survey findings illustration**



### Key points in the research results:

- Fewer than half of participants say administration is reviewed at least annually; the balance say it is not reviewed at all
- Research highlights factors that may affect decisions on the appropriate number of funds and the appropriateness, in different situations, of having a default fund
- A provider and two IFAs comment on what constitutes 'good value'
- There are wide variations in the frequency, volume and types of member communication; face to face consultations are thought to be the most successful way to communicate
- Researchers identify a tendency towards 'less rather than more' communication with members at or near to retirement
- Providers feel that governance of DC schemes is not as good as it could or should be
- Around half of DC schemes have some form of management committee in place, although some are extremely informal

The summary on the following pages focuses on areas of key interest.

## Administration of DC schemes

### Set up and review of administration services

Several of the schemes included in the research use third-party administrator (TPA) and this is reported to be more prevalent amongst trust-based schemes.

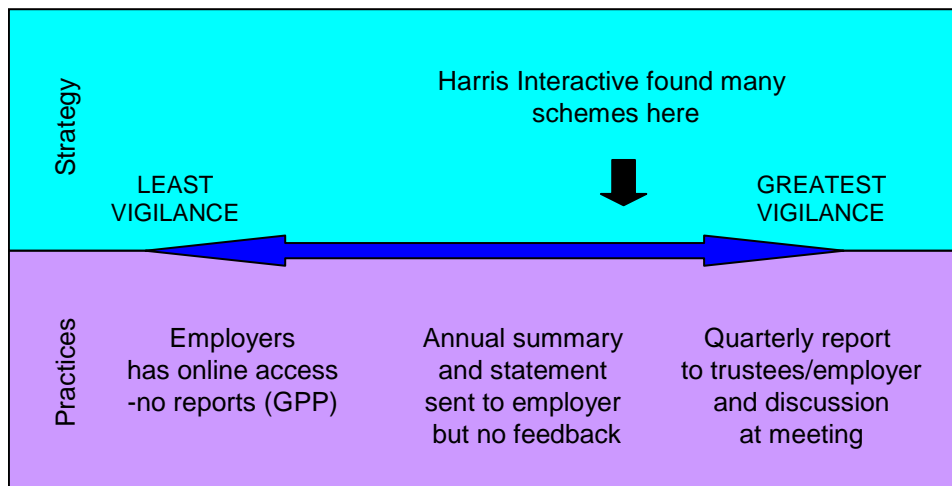
Research indicates that reports on administration are generally submitted to employers / trustees (and/or advisors) at least annually, but there are differences in how that information is utilized. In some cases, there is discussion about the report contents (and actions taken as appropriate), but in others, very little is done and the providers/administrators get little if any feedback. Fewer than half say they review their administration at least annually, and the balance say they do not review it at all.

There may, additionally, be some supervision of the administration by advisers.

There are examples of the provision of online access to information about administration which, to an extent, negates the need for reports, but it does require the employer/trustees to access that information proactively.

The researcher's view of administration practices is illustrated in Figure 2.

**Fig 2. Administration Practices**



## Service level agreements

A number of the schemes in the sample say they have a service level agreement (SLA) in place for administration. Whilst most of these are reported upon monthly, a notable number are reported on annually. Where SLAs are in place, they are usually quantifiable. They cover some, or all, of the following:

- administering payments each month;
- contact with new employees;
- delivery to website;
- benefit statement production;
- administering leavers/retirees; and
- FSA requirements, eg non-compliance.

"Performance is monitored against quantitative SLAs in quarterly reports. They cover all aspects of the main admin, including people transferred, retiring, monthly investment, an annual benefit statement, annual reports and accounts" **Administrator, DC large scheme**

Very often, the quantifiable part of the agreement relates to timescales. This is considered crucial for investment, and is also applied to other services like dealing with customer queries and renewal notices, eg 95% of actions taken within target number of days.

Reports may also include error incidence or standards relating to the quality of information. In the most stringent schemes, performance is measured against targets and financial penalties may be imposed accordingly. For example, in one case, if a service provider underperforms in any area, the underperformance is calculated as a percentage and the percentage then reduces the fees by that amount.

Larger schemes are in a position to be able to negotiate SLAs, whereas smaller schemes are more likely to make use of standard SLAs as defined by the provider or administrator. Two providers suggest that standard SLAs are better than negotiated as systems are set up to meet those standards, and this is said to minimise the chance of errors.

Not all participants agree that SLAs are necessarily the best way of ensuring good administration within a DC scheme. The alternative argument is that it is difficult to establish standards which can be measured and yet are relevant to the individual scheme at any particular point in time. Proponents of this view say it may be better use of resources to focus on areas of real need (for example, improving member communication materials), than to invest time and effort in achieving, for example, query response times.

"Not having SLAs means that we can move resources to the area of greatest need, eg with SLAs, you can bust a gut to get something out in five days that the client doesn't really need" **Provider, trust-based scheme**

"We don't have SLAs and it's a fear that we have that the Pensions Regulator will insist providers have them. We have deliberately not given our client SLAs as we believe it will give our clients worse standards. We know we are regarded, through surveys and rewards, that we give the best service consistently" **Provider, DC scheme**

"If you are poor, you need SLAs to get you back. If you are good, they're a millstone"  
**Provider, DC scheme**

### **Error reporting**

In spite of anecdotal evidence that administrators are reluctant to report errors which may reflect badly on their own performance, there appear to be no barriers to reporting errors, and where reports on administration are issued, they are very likely to include information about errors.

The overall response seems to indicate that errors are not seen as a very significant cause for concern.

"Every error gets logged on a system and has degree of rating depending on severity of error and is escalated up to management committees right up to CEO if very serious. We are not so bothered about the error but why the error was caused so we can take action. We have an error rate of less than 0.5%.

We also have a risk management system which reminds all employees electronically to do 'this, this and this' every month. Apart from external auditors we have internal auditors who look at systems and examine everything – annual surveys with recommendations which go to the board with target dates on when corrections have to be done.

Biggest errors are mis-keying but that will be a thing of the past as we are moving to straight through processing. The one area that the pension industry would benefit from legislation would be the creation of standards so that we are all operating on the same systems. The format in which you get information varies tremendously. We are all operating on different systems. In US they have standards"

**Provider, DC scheme**

## Checks and measures

Key points to emerge from the research in relation to checks and measures are outlined below:

*Prompt payment* is seen as the most important area where mistakes can directly impact the member. It is important that money is taken quickly and accurately from the payroll and invested as soon as possible to avoid missing any advantageous moves in the market, so systems need to be in place to ensure this happens.

"Prompt payment of the contribution is the most important thing and the one most likely to go wrong" **Employer, DC large scheme**

"The errors are written in the log so people can look at it and say, 'Well that was a human error' or 'That was due to a systems error'. Then [provider] have a project team in place to try to ensure that errors do not recur" **Provider, GPP**

"When contributions are deducted from pay, they should be applied as quickly as possible. Some providers find it very difficult to apply contributions if they are not monthly. So where you've got payrolls where you've got multi-frequency (weekly / fortnightly), certain providers find that impossible to deal with. That's when administration can fall badly wrong because you've got employers deducting moneys on a weekly basis and trying to make contributions on a monthly basis" **IFA**

*Accuracy of records* is often seen as more of an employer issue. Administrators and providers say that once the data is in their system, inaccuracies are minimised by automated processes, wherever possible. However, some manual processes are said to remain and human error could still occur, so some form of manual intervention or checking is considered to be necessary, if accuracy is not to be reliant upon the member spotting any errors at a later date. Some schemes have the benefit of advisers carrying out ongoing research into employers systems to ensure accuracy. One to one meetings with members are also cited as an opportunity for details to be checked.

"The biggest problem is at the company end associated with payroll – most problems emanate from that area. No companies have efficient HR payroll, not even the best ones" **Provider, DC scheme**

"People not advising us that they've left service, or new members joining. Generally they run fairly smoothly, but errors always occur when you've got manual intervention" **IFA**

"All processes are subject to quality controls. If it's a manual process, there's accreditation of staff to ensure competence and ongoing quality checks – reports are produced off the system" **Provider, GPP**

"There is the possibility of human error occurring. It's imperative that the administration processes are efficient and that there are no time delays in investment - that the investment processes are as effective as possible. They could breakdown because of human error" **Provider, GPP**

"There's not really any human touch applied at all. The information comes in and goes on to the plan automatically. Any errors would be for the members to pick up really. It would be quite difficult for us to identify" **Provider, SHP scheme**

*Checks on accuracy of contribution allocation and reconciliation* are not generally considered to be a major issue. Providers feel they are well set up and equipped, and the introduction of electronic billing makes it easier still.

"We reconcile as we go like a bank. We have straight through processing systems that allow us to do that" **Provider, DC scheme**

Any new schemes now have to go on the e-billing system/internet system: "Everything goes on there to make it more of a streamlined process and make it easier for the client company and financial advisors. It makes it a lot easier on our side as well because a lot of the onus is on the administrators and the financial advisors to get things right"  
**Provider, GPP**

## **Complaints**

A small number of interviewees are aware of complaints being made about DC schemes, and whilst there is general agreement that complaints do constitute a basic indicator of the success of the scheme, there is debate about the true validity of that measure. The doubt relates to the low level and the nature of complaints that are made – more often, it is felt that complaints are a consequence of lack of understanding on the part of the members, rather than a problem with the scheme itself. Complaints procedures tend to be in place amongst both employers and administrators, although few examples are given of them being used.

All in all, participants do not appear to attach a high level of significance to complaints either as an indicator of good practice or as a means of ensuring any inaccuracies are rectified.

## DC investments

### Number and choice of funds

Research shows a wide variation in the number of funds offered, varying from a limited choice of 3-5 (equity, bond, cash), right up to a range of several hundred funds.

The researchers set out their analysis of the key issues relating to fund choice:

*"There is a debate about what is the best approach to use: advocates of the wide choice say that members should have access to that many to ensure there is something suitable and that the members' choice is not being falsely or unwisely limited. There could also be a case made here for reducing potential liability: If a full choice is available and the member makes a bad decision, at least the 'right' fund has been made available. Advocates of a smaller number of funds recognise the fact that members generally do not understand what they are looking for and potentially have low levels of interest. Therefore, by minimizing the number of funds available, it should theoretically make choosing easier for members, and it could be construed to be a 'damage limitation' exercise." Harris Interactive.*

The specific choice of funds on offer is most likely to be based upon the advice of an adviser and/or provider. A lifestyling option (which is a mandatory option on stakeholder pension schemes) is offered by around half the sample. The profile of eligible members is a factor for fewer schemes.

There are indications that contract-based schemes are more likely to have a larger number of funds available than trust-based, although this is not always the case. This would fit with the potentially lower level of employer involvement observed in relation to contract-based schemes and the apparent tendency for some employers to distance themselves from responsibility and any liability that could possibly ensue.

Researchers note that a number of employers do not know how many funds are available through their DC scheme and this is more likely to be the case in contract-based schemes.

*"Our belief is that in DC schemes, there is an optimum number of funds - between 5 and 15 - depending on the nature of the workforce and their investment sophistication. We would strike a balance between offering sufficient choice to invest appropriately but not so much as to lead to confusion" IFA*

*"Some schemes have dozens, possibly hundreds of different investment options. There are different opinions on this but my personal view is that too much choice is a bad thing, it's better to have a reasonably contained choice of good managers covering a variety of different ways of investment. Some schemes will have a choice of half a dozen different UK equity managers – now how on earth are people supposed to be able to choose which of those to go for?" IFA*

## **Default funds**

The majority of DC schemes in the research sample offer a default fund. Where a default fund is offered, anything from around two-thirds of members up to almost all have investments in that fund. It is said that once their investment has been made in the default fund, few members subsequently switch to alternative funds.

Where a default fund is offered, the proportion of members whose investment is in that fund appeared to depend on a number of factors, for example:

- member profile (schemes with a largely blue-collar membership are likely to have more members investing in the default fund);
- the efforts made by the employer/trustee to actively involve members in decision-making; and
- whether individual one-to-one advice is both available and actively encouraged;
- the nature of the default fund and the appropriateness of the fund for the members.

Reportedly, default funds tend to be recommended by an adviser. In general, they are designed to offer a balanced investment and are likely to be lifestyle-based. Participants did not always know or volunteer the composition of the default fund in question, but four are specified as follows:

- global passive equity/lifestyle;
- managed lifestyle;
- mix of balanced managed, balanced funds and fixed interest; and
- equal mix of global passive and global active.

Participants have mixed views on the appropriateness of offering a default fund. Reportedly, those who advocate a default fund say it ensures that members are not making choices that are inappropriate and too risky. Important too, is the fact that the majority of members do not switch funds, therefore they need to be in something that can deal with their lifetime needs. Those who are not in favour of default funds, say that the presence of a default fund makes it too easy for members – they want to encourage members to make an active choice rather than

just taking the easy option. Such schemes are also likely to make individual advice available to members.

A more negative view also emerges, suggesting that schemes without a default fund are being driven by fear of litigation. But, on balance, the issue appears to be more about whether or not members are really in a position to make a considered decision about their investment.

Default funds appear more likely to be on offer from a contract-based scheme than a trust-based scheme, which would fit with the apparent lower levels of advice and guidance available through these schemes. Similarly, potentially a greater proportion of members appear to be in the default fund in contract-based schemes.

"The default fund provides the generic answer for people who are not experts in this field. They have faith that we employ the right organisation to give advice. That may not be the best for each employee. They could make better decisions for themselves if they understood the process more. Most people are not prepared to do that. Some might be better off. The issue is about the balance of risks against reliable returns. Some people are more adverse to risk. We have issued a document about risk so people can make their own choice" **Trustee, DC scheme**

"Our view is that the level of investment people will make over a period is important enough for them to make active decisions so the trustees don't subscribe to a default position or it's too easy for members to take the easy option – we want them to make active decisions. At every turn we are encouraging employees to take an active role in their pensions" **Employer, large DC scheme**

"With schemes with an enforced choice, I believe members are worse off than if they had a default. Members often go into inappropriate funds and at least with the default, the trustees are monitoring the default, and the default is usually better than the members own selection" **Provider, DC scheme**

"The main reason for offering a life-styling approach is that we don't give individual investment advice to the members of the scheme, therefore they need some guidance. The default fund is a medium risk fund and we explain to the members and we actually issue a question and answer sheet as well as the insurer's material explaining the nature of the fund and also explaining to them that they have access to a whole range of different funds should they wish to consider them" **IFA**

"90% don't change fund and stay in the one they started with" **Employer, AVCs to DB scheme**

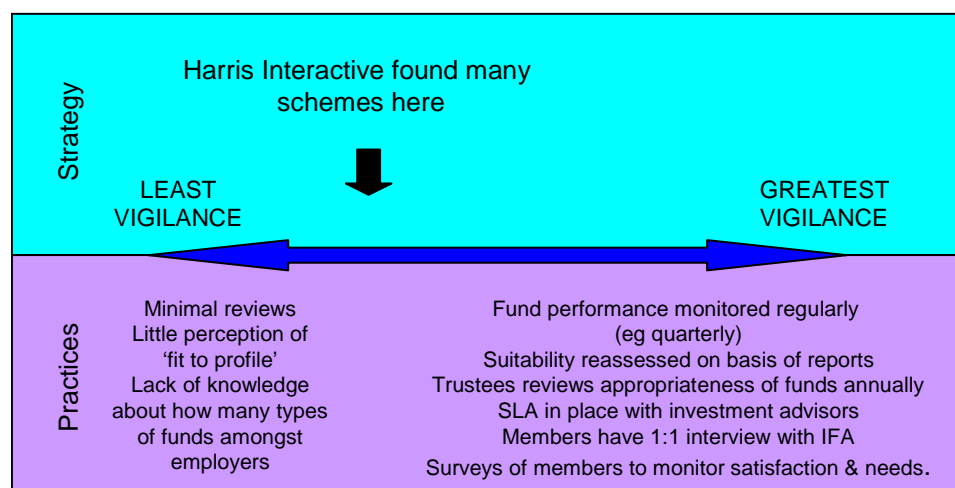
"Lifestyle strategies by pension schemes generally need to be thought through. One of the problems of targeting a retirement of course is that not everyone knows when they are going to retire. More work needs to be done on that sort of thing" **IFA**

## Review of investment fund choices

Fund performance is monitored to varying degrees, with examples of some trustees receiving quarterly reports and actively agreeing to changes in funds if appropriate. The suitability of funds appears to be most commonly reviewed every 2-3 years, with some reviewing them annually. There is a small number however who say they never review the suitability of funds, and there are examples where it has taken a change elsewhere in the system to prompt a review. Research indicates little difference in review strategy by scheme type.

Harris Interactive found many schemes operating practices that did not suggest high levels of vigilance. This is illustrated in Figure 3.

Fig 3. Investment Strategy/Practices



"(Investment consultants) provide us with a performance chart which evaluates the fund against the market every quarter so we can control the performance of the providers. The trustees have just made a decision to look at a case of under-performance over the last few years" **Trustee, DC**

## Charges

The research indicates that charges are generally incorporated into the unit price. Most employers and trustees participating in the research know approximately the level of charge being applied. Charges are one of the factors taken into consideration when selecting a provider. The negotiation, awareness and monitoring of both investment and administration charges appeared to vary from scheme to scheme.

Harris Interactive observe that, in their view, the most conscientious attempt to ensure charges are fair to members is identified in a case where charges are linked to performance: if fund or administration performance drops, charges are reduced.

Charges are communicated to members when they join the scheme and in their annual statement and, in addition, may be mentioned in newsletters. There are, however, few examples of efforts made to ensure members understand what they are being told (such as Q&A sheets), and it is commonly thought unlikely that members are either aware of, or understand, the charges they are paying. It is not clear that they are aware, for example, that higher risk funds may carry higher charges.

To ensure understanding, it is thought necessary for one-to-one advice to be available to members, although it is also said that simple improvements to literature could aid understanding.

There are few notable differences by scheme type in terms of charges.

*"Costs are picked up (by members) through the prices they get for their units"*  
**Administrator, DC large scheme**

*"Fees are not hidden but they are not well communicated. The details are in with the details of the fund choices but most take the default so I doubt they really know what the fees are or even if they pay any. They may take it into account when they switch but hardly anyone switches"* **Employer, AVCs to DB scheme**

*"When choosing funds, members are informed what the charge will be, but people don't understand percentages. In presentations I never talk in percentages. If the fee is 0.1%, I always say for every £100 in your fund, we take 10p. People can relate to that. But in writing, it all goes back to jargon. It would be good to use that example in literature"*  
**Provider, DC scheme**

## Defining 'Good value'

Interestingly, although charges are one of the points of consideration claimed to be instrumental in the set up of a DC scheme, few participants have really considered what might constitute 'good value'.

Some participants suggest that value for money is dictated by market forces. On a specific level, they relate it to efficiency and quality, for example, in administration:

- the issuing of quarterly reports;
- meeting deadlines (which may be SLA driven);
- no complaints (although this is not necessarily recognised as a measure of a successful scheme).

On a broader level, it refers to the availability of a full service and advice.

*"(It's) partly a competitive thing. If you're tendering a new scheme, you'll have 2-3 providers and intermediaries and you will get a feel for who is offering good value" IFA*

*"It's what else you're getting – what back up service – is it short termism or are they going to look after clients long term: continued advice to members, education of members and keeping people up to date, explaining to new members"*

**Provider, SHP scheme**

*"A good range of funds, good performance, an appropriate attitude to risk from the client and appropriate management from the adviser, regular review to keep up to date and changes made when they are necessary. Care and service provided to our client" IFA*

## Communications and member understanding

Despite its importance, wide variations in the frequency, volume and types of member communication undertaken are apparent in different schemes.

*"Mostly these variations are driven by employer interest and responsibility as with so many other aspects of the schemes, and strategies can vary from those employers who completely hand over communication to a third party, right up to those who are proactively looking for new ways of really communicating with and engaging their members."* Harris Interactive

In the schemes where less vigilance is observed, members get all their communication when they first join the scheme, and then nothing thereafter, apart from the compulsory documentation.

*"Marginally better are those schemes which at least undertake some form of 'reminder' to members to review their arrangements in with the annual statement. This applied to around three-quarters of the schemes included in this research. The schemes which give the member the greatest opportunity to engage with their pension are those which have good consultation in the early stages, followed up with regular reminders to review their provision."* Harris Interactive

Written communication is the most common form – supplied in all cases in the research either in isolation or supported by alternative methods.

*"Potentially of greater benefit to members is having alternative means of communication. Helplines are offered in around a fifth of instances, either by the provider or advisor; and some make efforts to have open days where members have access to key personnel such as an advisor, a representative from the provider and / or trustees. Around a third of the schemes researched offered a website or intranet. The disadvantage of these approaches is that they require motivation from the member to ring the helpline or attend the open day – an issue with a disinterested and lethargic membership."* Harris Interactive

Participants consider the best approach to communication is to utilise a wide range of methods. Those supported by face-to-face consultations are thought to be the most successful. However, only a small proportion of the research sample offer one-to-one consultations or forums.

Whether communications strategies are **successful** is reportedly a difficult assessment and not always one that has been considered. The most obvious measure might be response rates, whether that be take-up rates or number of enquiries. However, it is reported that there are relatively few changes undertaken by members, certainly in terms of changing funds. The most common changes are said to be those relating to contribution rates.

The **barriers** identified to successful communication are reported to be multifold. They include:

- the complexity of the subject matter;
- the need for face to face (ideally one to one) communication to allow an effective exchange of ideas;
- geographical constraints – members may be widely dispersed making it time-consuming and costly to reach them all;
- costs; and
- what was described as an attitude of lethargy amongst scheme members.

A consequence of poor communication itself means that relatively few comments are made on whether members are making informed decisions in relation to their pension.

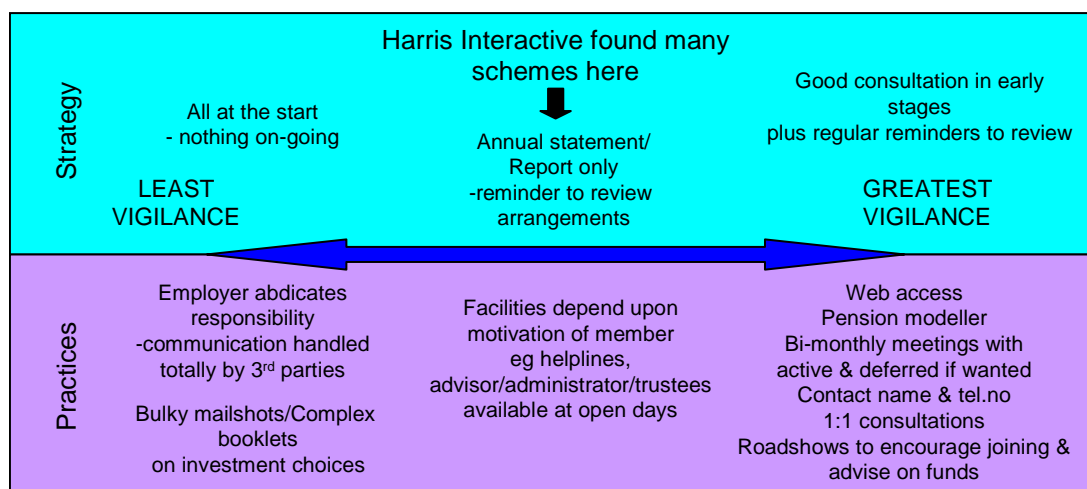
It is said that the amount of regulation surrounding pensions and an increasingly litigious society generates a fear of giving advice amongst the 'unqualified' (employers, administrators, providers) when, actually, an improved level of guidance could result in a better level of understanding and engagement from the members.

*"Commonly, many do not take advantage of information opportunities and are generally disengaged from their pension scheme. With many of the communication methods relying upon members taking the initiative, this poses a difficult issue. There appears to be a need for more 'push' communication techniques rather than 'pull'. Such techniques obviously include the 'ideal' face-to-face approach, but conceivably more could be done to improve the understandability of literature too."*  
Harris Interactive

Basic, lower cost forms of communication are said to differ little by scheme type. Within trust-based schemes, members are reportedly more likely to receive information from the employer (in addition to that from the provider and/or advisor), and one-to-one sessions or forums are also more commonplace amongst these schemes (although still in a minority).

The researcher found many schemes operating practices not considered to be at the more vigilant end of the spectrum. This is illustrated in Figure 4.

**Fig 4. Communications with members**



"(Members are reminded to review arrangements): *Very much so – both at set up and on an ongoing basis. A communication will go round the company to say there'll be a surgery day for new and existing members. Part of the joining process is to stress the importance of monitoring whether you are on track or not. Part of that is the use of an on-line pensions modeller ... it's also available on our website to encourage people to use it on a regular basis*" **IFA**

"Nobody takes any notice of anything to do with pensions. You don't know how successful it is. You send out a letter and there is no response" **Employer, GPP**

"Written communication is not as successful as word of mouth" **IFA**

"There's very little communication – only when they have queries. The [provider] used to send update leaflets and we would pass them on. There's no get together" **Employer, SHP scheme**

"Periodically we provide advice. We talk about performance and the default fund. [Adviser] help us run roadshows to encourage more people to come into the pension scheme and to help people with any queries about the default fund and to give them some basic advice and understanding. We provide literature and help people understand what the default fund is" **Trustee, DC scheme**

"Personally I don't think it really costs the company anything to go for a more collaborative system, helping the members get as much understanding as possible with presentations and one-to-ones. It's just a bit of time for their HR to pull it together and organise it with some time away from their desks for the members – it's not a huge cost to them. So yes, some companies could do more ... It would result in a more educated membership. From doing the one-to-ones it's obvious that a lot of them don't really understand what it is they've got. They've taken out this plan, but when you actually sit down and talk to them, a number of them have little understanding of how it works. So recently with the markets going down, they wouldn't understand the implications of that activity. They don't really understand what happens when they retire and how it converts to pension" **Provider, SHP**

*"It has now reached the stage where most of our schemes are uneconomical to run on a full-service basis, ie giving individual advice to members, which is why we've opted out of that. 1% per annum doesn't generate sufficient income in the form of commission to provide a higher level of service, so service levels have been reduced, except where we've had discussions with employers and agreed to operate on a fee charging basis or on a higher charge basis. Basically I think SHP have forced costs down but they have also forced the level of advice down" IFA*

*"The problem is that if you send people lots of bits of paper, most people don't tend to read it as far as pensions are concerned. The fact that there are various things web-based is great, but you've still got to try to encourage people to use them ... The one area they perhaps could do more on is more either presentations to people or CDs or things on the intranet or whatever that are not paper based ... The costs are a consideration, very much so and with 1500 people spread all over the UK, doing presentations to encourage people and explain more about the pension scheme is quite a costly business – that's why they haven't done it!" IFA*

*"The company is considering the introduction of a pension modeller because the company offers a range of contribution rates between 3 and 6% and the company will match that" IFA*

*"I think the requirements on pensions schemes to set out the benefit projections in the statutory format are next to worthless, they don't really give then a good idea of what level of pension they're going to get , they are horrendously complicated. There is a communication issue there' ... 'All trustees and indeed the regulatory environment need to think about better ways of communicating information to members" IFA*

## **Retirement choices**

The choice of a retirement benefit is a key area where participants identify a difficulty resulting from the complexity of the subject matter and members' inability, or even unwillingness, to understand the options available to them, and a general lack of interest associated with pensions per se.

The research indicates that the amount of assistance offered to members at retirement varies according to the level of responsibility accepted by the employer. There are examples where the employer does nothing to help the member to prepare for retirement or how to deal with their retirement options. In some other examples, employers support the member in preparing for retirement through things like retirement seminars and consultations, and actively encourage visits to an IFA. Cost is, however, an important consideration here.

In the cases where the greatest vigilance is demonstrated, the employer pays for an annuity broker service and/or an advisor to consult with retiring members. Harris Interactive identify a tendency towards less rather than more communication and assistance at the current time.

Differences are also identified between communications members receive from different providers. All members receive a mailing with information about the value of their fund and the choices for annuities, and very often this is supported with access to a helpline, but this mailing may be sent out anything from six weeks to six months prior to retirement.

Indications are that around half the schemes included in the research offer 'open choice', although as already mentioned, advice may or may not be available. A smaller number offer 'default' or 'assisted choice'. When an open choice is available, around half of members are believed to take the open market option and there is a perception that this proportion ought to be higher. There is also the consideration that the members' choices may be limited by the size of the fund.

Note: The terms 'limited choice', 'default', 'open choice' and 'assisted choice' were described to participants, as follows:

'default'

- scheme administrator gives quote from annuity provider with whom they have a relationship
- individual member has option to access open market

'open choice'

- similar to default choice
- individual is left to decide for themselves what annuity they want and from where
- trustees have minimal involvement in the process

'assisted choice'

- scheme has relationship with annuity advisory firm
- members approaching retirement are directed to firm
- members receive help choosing best annuity for their circumstances

'limited choice'

- scheme rules specify annuity type
- individual member not given any choice of annuity type
- trustees find best price
- if member does not like the choice, then has to transfer out of scheme

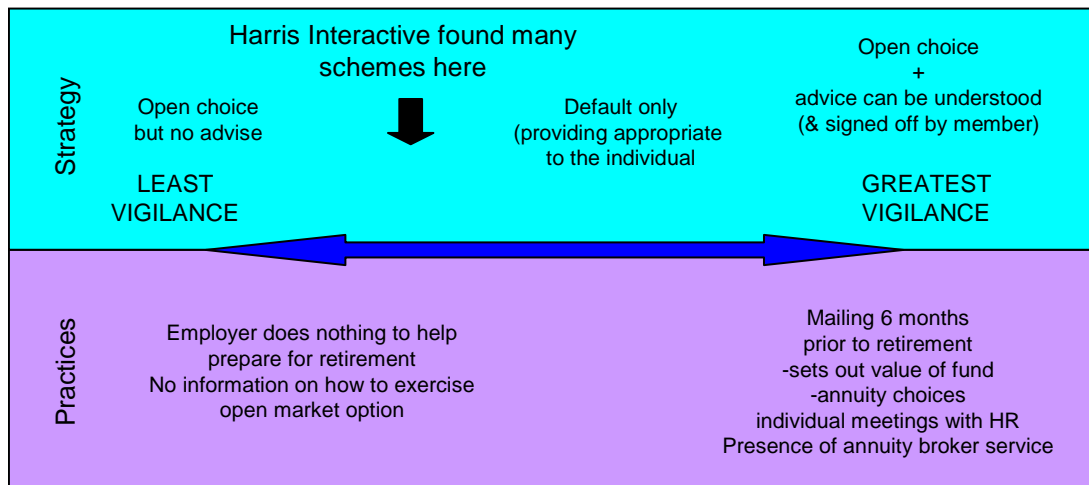
Participants are asked a question to establish which broad arrangement is offered by the scheme in question.

There are differences in retirement choices offered by scheme type. Contract-based schemes appear to be most likely to offer open choice, with some offering assisted choice. Amongst trust-based schemes, open choice and default appear to be offered in almost equal proportions, with slightly fewer offering assisted choice. Respondents of trust-based schemes were also more confident that members were making well-informed decisions to suit their circumstances which would fit with the generally closer level of communication and acceptance of responsibility that is observed amongst these schemes.

An important point to note is that several schemes covered in this research as yet have had no-one retiring, so little thought had been given by employers as to what would or should happen.

The researcher finds many schemes operating practices which appear to them to be associated with the lower degree of vigilance.

**Fig 5. Retirement Choices**



*"People find DC schemes fairly simple to understand, in that whatever money you pay in it goes into a pot and hopefully grows with investment returns and it's all very simple until you get to the retirement phase when people don't understand it at all"*

**IFA**

*"We contact members through trustees at various stages and suggest they take independent advice (open choice). Members do not make the right choices as not enough good inexpensive advice is out there"* **Provider, DC scheme**

*"It's between [Provider] and members ... Members get a quotation package. They would have two or three options ...I think most go through [Provider] but the more savvy get a better annuity ... There's no help. It's an individual thing. We don't give advice"* **Employer, SHP scheme**

*"Dealing with inertia. When they retire, people's inclination is to ring the company that holds the money, get a letter through saying 'sign here and we'll give you the money', and that's generally what people will do, particularly if it's not a large sum of money"*

**IFA**

*"You need to know (what the choices are) and I don't think people know. People don't understand the options available. We encourage them to speak to our advisers but not all of them did that in the old scheme. We paid an annual fee to advisers to cover the options so employees don't have to pay to see an independent financial advise"* **Employer, GPP**

*"More members should be exercising the open market option if they had more confidence, if they were seeking advice"* **Trustee, DC scheme**

*"We write to members six months in advance of retirement. We tell them the fund value and they would come back and complete a retirement questionnaire. We will then obtain a quote to suit their circumstances. We discuss with them on the telephone or in writing ... The main difficulty is their level of understanding. It's difficult to advise about legislation"* **IFA**

## DC governance

### Responsibility for good governance

Research participants make the following general observations in relation to scheme governance:

- Providers, in particular, feel that governance of DC schemes is not as good as it could or should be.
- They identified the need to have a 'body' in place that is willing and able to take necessary steps to ensure good governance.

In **trust-based schemes** the responsibility for good governance falls to the trustees; to govern effectively, trustees need to have sufficient understanding of the potential risks to members. In **contract-based schemes**, the responsibility for the governance of the scheme is less well-defined.

Some providers feel that employers are 'handing off' responsibility for contract-based schemes to them, and this is confirmed by some employers. It was considered by some that the presence of a properly constituted management or working committee would cover the gap.

Participants consider a regular system of review is important to ensure the scheme is running well. That review could/should cover all parties involved and all aspects of the scheme (eg fund performance and suitability, efficiency of administration, charges, communication with members). In a contract-based scheme with a management committee in place, the review is generally carried out by the management committee.

Importantly, it is considered that reviews should be carried out with a willingness to make changes if necessary, which, reportedly, is not always the case. In particular, there is a reluctance to replace the provider or an adviser.

### Management committees

Research identifies around half of contract-based schemes having some form of management committee in place, although in some cases they are extremely informal and not always recognized as such, and they may or may not have any written terms of reference. It appears these committees are likely to be recommended by an adviser, and comprise at least one employer representative (pension manager, Human Resource representative, Finance Director, Managing Director or Chief Executive Officer) and possibly a member or Union representative. A representative from the adviser and/or provider is also likely to be present at meetings.

It is noted that not all employers are very clear about the specific role of these committees – just that they have been advised to put such a group in place.

*"Sometimes there is not sufficient diligence or governance to ensure that the scheme is operating as expected. There's not so much governance required from employers"*

**Provider, DC Large scheme**

*"Ongoing there's a pensions committee that meets six monthly: representatives from the employer, the provider, employee representatives and advisor. We have a set criterion that we're looking at to measure success from the scheme's perspective around take up rates, contribution rates, investment mix and also monitoring things like a non-joiners survey to understand why people hadn't joined the pension scheme" IFA*

*"How we tend to establish them depends on the employer in most cases, but we would normally set it up as an oversight and reporting group. That would have some key indicators as to what they wanted from the scheme and how they wanted to manage it. In the event of something failing, they would have a duty to report that back to the employer for the employer to decide what action to take. Companies and individuals seem to be keen to remove personal or company risk as much as possible. By having some clear reporting and oversight, they feel that's limiting the risk to those who are running it rather than turning into a pseudo trustee board" IFA*

*"The company is reviewing the scheme to make sure the employees are getting maximum benefit and that they are sufficiently involved" Employer, GPP*

## Methodology used in The occupational DC landscape

Under the Pensions Act 2004 the Pensions Regulator is required to 'compile and maintain a register of occupational and personal pension schemes which are, or have been, registrable schemes.' (Pensions Act 2004, section 59 (1)). Registrable schemes include most occupational, personal and public service pension schemes.

The Pensions Regulator also produces a pension scheme return requesting certain information, including data such as the type of scheme, the date the scheme was established, number of members (active, deferred and pensioner), etc. Scheme returns have not yet been issued for personal pension schemes and hence the occupational DC landscape only includes data on occupational schemes.

The first set of DC only scheme returns were sent in April 2006. Just over 10,000 returns were sent, and of these around 6,000 were returned and processed as of June 2007. The data for these 6,000 schemes was cleansed, with some schemes being removed from the data set as they had told us that either they had no members or no assets. Having performed the data cleansing we were left with scheme return data for 5,395 schemes. This represents fewer than 7% of DC only occupational schemes, however, as the scheme returns were targeted at larger schemes, the information we hold represents 29% of members of DC only schemes.

In addition we have received just over a thousand scheme returns for hybrid schemes. Performing the data cleansing exercise as with DC only schemes we were left with a data set of 996 hybrid schemes.

The next batch of DC scheme returns have been sent out for completion (from December 2007 until early 2008). This will mean that our next analysis of DC scheme return data will have the benefit of a larger data set, and should give us a more complete picture of the DC market.

However, the current version of the scheme return does not ask for the value of scheme assets for DC schemes with fewer than 12 members, as many stakeholders have advised us that it is not practicable to provide this information.

## Methodology used in Harris Interactive DC risks qualitative research

In July 2007 Harris Interactive was commissioned to undertake in-depth qualitative research focusing specifically on risks to occupational schemes offering benefits on a DC basis, including both trust and contract based schemes.

The research involved three distinct stages, designed to be respondent-led to enable interviewees to identify and discuss risks that they felt were most significant, and where they, therefore, felt that the regulator should focus its attention.

An initial triangulation exercise was undertaken with representatives from four schemes. In two trust-based occupational schemes the employer, provider, administrator and trustee were interviewed whilst in two contract-based schemes the employer and provider were interviewed, either face to face or by telephone. This process was designed to provide an overall picture of the scheme, and allow an assessment of the differences in view points between the relevant parties.

The second stage of research consisted of 32 individual depth interviews with employers, providers, administrators, trustees and IFAs representing a broad range of schemes in terms of scheme type (eg DC only, hybrid, AVC to DB, GPP and SHP) and size of membership. Interviews were conducted either face to face or by telephone, and the findings were used to inform the third stage of the research.

The final phase of the research included 21 semi-structured interviews, again undertaken with a broad representation of relevant audiences and schemes.

Analysis of the information collected was undertaken on a rolling basis, with each stage of research informing the subsequent stage.