

## Q&As: DC schemes

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These Q&As bring together some of the key issues from our DC guidance, providing links to other relevant guidance and our Trustee toolkit where relevant.

We also suggest further reading from other organisations.

This guidance does not include any new requirements over and above those that already exist.

### Key points

- These Q&As are primarily for trustees and employers with DC schemes. These include trust-based schemes (including DC AVCs), contract-based personal pensions with a direct payment arrangement and stakeholder pensions.
- The Q&As will also be of interest to others involved in running these schemes.
- We've grouped the DC topics under seven headings:
  - Regulation
  - Governance
  - Administration
  - Investment
  - Charges
  - Retirement
  - Member understanding
- You may want to read through all the Q&As as a refresher on DC issues (eg prior to trustee meeting), or dip in to sections that are of particular relevance to your scheme at the time.

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## Regulation

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### Why is the Pensions Regulator getting involved in DC schemes?

- We regulate work-based pensions and will be the regulator of the personal accounts scheme.
- We have a responsibility set out in legislation to regulate DC schemes that are work-based pensions.

These include:

- occupational pension schemes;
- personal pension schemes where direct payment arrangements exist (whether in respect of employee or employer contributions); and
- stakeholder pension schemes.

For convenience, in this guidance we refer to the schemes in the last two bullets above as group personal pensions (GPPs).

- We work closely with the Financial Services Authority (FSA) who has regulatory responsibilities in relation to GPPs.
- Virtually every pension scheme has DC benefits whether these are main benefits or additional voluntary contributions (AVCs). At the moment it looks as though DC will be the principal form of pension provision for many employees in the future. It is therefore critical that firm foundations are laid for the growth of DC schemes and the introduction of personal accounts.
- The House of Commons Public Accounts Committee has recently completed a report on the regulator ([www.publications.parliament.uk/pa/cm200708/cmselect/cmpubacc/122/122.pdf](http://www.publications.parliament.uk/pa/cm200708/cmselect/cmpubacc/122/122.pdf)) in which it makes clear its expectation that we will direct our regulatory effort towards DC schemes.

- Our governance survey, responses to our DC consultation and qualitative research indicate that there is potential for improvement in the governance of DC schemes, particularly smaller ones (all documents available on our website).
- Certain aspects, whilst important for other parties, fall outside our statutory remit. In particular, it is not the regulator's job to encourage people to join pension schemes or to encourage them to pay increased contributions.

Our role is to improve confidence in work-based pensions by protecting members' benefits and encouraging high standards and good practice in running pension schemes.

### **What action is the regulator taking to improve the running of DC schemes?**

- In order to mitigate risks to members' benefits and to help people take opportunities to build on existing good practice, we're adopting the following approach:
  - providing education and guidance;
  - working in partnership; and
  - intervention proportionate to the level of risk
- We've produced e-learning for trustees and codes of practice. Working with people who have an involvement in pension schemes and with other government bodies (the FSA for example) we're producing good practice guidance. You might want to take a look at our guidance on employer involvement in GPPs ([www.thepensionsregulator.gov.uk/employers/engagement/erEngagement-01.aspx](http://www.thepensionsregulator.gov.uk/employers/engagement/erEngagement-01.aspx)), the retirement options process in occupational schemes and our consultation document ([www.thepensionsregulator.gov.uk/pdf/WindingUpConDoc.pdf](http://www.thepensionsregulator.gov.uk/pdf/WindingUpConDoc.pdf)) on speeding up winding up.
- Where issues arise, we work with those involved to resolve them, for example recovering unpaid contributions from employers.
- In most cases, education, dialogue and collaborative working mean that there is no need for further intervention.
- However, we have powers that we can use as a last resort, for example we can issue improvement notices where there has been a breach of legislation, we can appoint trustees and we can wind up schemes.
- We will, of course, act sooner where the circumstances require, for example in possible cases of fraud.
- The focus of both the Government and the regulator is on raising the standards of the many schemes towards those of the best.

## **Does the Pensions Regulator run the risk that it will add to the challenges of running DC schemes?**

- We're committed to ensuring that the regulation of DC schemes is proportionate to the risk to members' benefits.
- We've discussed this issue with many stakeholders and we understand the worry some people have that employers may be discouraged from offering DC schemes due to over-regulation.
- The requirements on trustees derive from the following main sources: legislation, the rules of the scheme in question, and trustees' duties from case law.

The regulator is not the originator of these requirements – our role is to encourage trustees and others to meet the requirements. Ultimately, the regulator may take action if they do not do so. We will take no action against trustees who fulfil their duties and obligations.

- We will continue to fulfil our statutory objectives by providing guidance and good practice examples for the many employers and trustees who want to improve the way their scheme is run.
- The House of Commons Public Accounts Committee has recently completed a report on the regulator ([www.publications.parliament.uk/pa/cm200708/cmselect/cmpublicacc/122/122.pdf](http://www.publications.parliament.uk/pa/cm200708/cmselect/cmpublicacc/122/122.pdf)) which comments that “in the regulation of money purchase schemes...much remains to be done [by the regulator] in improving standards of scheme governance and communications with members.”

## **Who regulates occupational DC schemes?**

- The Pensions Regulator is the UK regulator of work-place pension schemes. These can be divided into two broad groups:
  - group personal pensions (GPP); and
  - occupational schemes which are usually set up under trust by an employer for the benefit of its employees.
- We regulate the vast majority of private sector occupational DC schemes and requires that these schemes register with us. Information about registration is available on our website.
- We also have some regulatory responsibilities in relation to certain aspects of public sector schemes.
- The FSA does not regulate occupational schemes, although they usually regulate the investment managers appointed by trustees of these schemes, in relation to their investment management activities.

- Occupational schemes need to register with HM Revenue and Customs (HMRC) in order to gain taxation advantages for the employer and members. Find out more about registration with HMRC by viewing the registered pension schemes manual ([www.hmrc.gov.uk/manuals/rpsmmanual/RPSM00300000.htm](http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM00300000.htm)) on the HMRC website.
- Employers can also apply to HMRC for their occupational scheme to obtain contracted out status. Find out more on the HMRC website ([www.hmrc.gov.uk/manuals/rpsmmanual/rpsm02403050.htm](http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm02403050.htm)). And see Governance - What impact will personal accounts have on existing DC schemes?

### **Who regulates group personal pensions (GPPs)?**

- Legislation puts responsibility for regulating GPPs on both the FSA and the Pensions Regulator. We focus our attention on different aspects, as required by the legislation which has given each of us different objectives and powers.
- The FSA regulates the providers of all personal pensions, whether or not there is any employer involvement. We only regulate work-based personal pensions, ie where contributions are paid by the employer (either on its own behalf or where it is remitting the employees' own contributions) and stakeholder pensions.

Personal pensions fall outside the Pensions Regulator's scope once there are no contributions being remitted via the employer.

- The FSA focuses mainly on sales, marketing, disclosure and the prudential management of providers, for example systems and controls, and the appointment of senior management.
- Some key areas that we focus on are good governance, administration and employer responsibilities.
- In areas of interest to both regulators, for example administration, we liaise closely.
- We've produced a guide ([www.thepensionsregulator.gov.uk/pdf/TPR\\_FSAguideOnRegulationOfCBschemes.pdf](http://www.thepensionsregulator.gov.uk/pdf/TPR_FSAguideOnRegulationOfCBschemes.pdf)) jointly with the FSA on the regulation of GPPs, including examples of how specific scenarios would be approached.

### **Why is the Pensions Regulator involved in GPPs when the policyholders are individuals?**

- We have a statutory responsibility to regulate DC schemes that are work-based pensions.

These include occupational pension schemes, personal pension schemes where direct payment arrangements exist (whether in respect of employee or employer contributions) and stakeholder pension schemes.

The Pensions Act 2004 gives us specific objectives in relation to these schemes.

- Personal pensions fall outside our scope once there are no contributions being remitted via the employer.
- The FSA also has regulatory responsibilities for personal pensions and stakeholder schemes and we liaise with them to ensure a joined-up approach to regulation.

The respective roles of the two regulators are set out in our joint guide ([www.thepensionsregulator.gov.uk/pdf/TPR\\_FSAguideOnRegulationOfCBschemes.pdf](http://www.thepensionsregulator.gov.uk/pdf/TPR_FSAguideOnRegulationOfCBschemes.pdf)) on the regulation of work place contract-based pensions and our Memorandum of understanding, both available on our website.

### **Is a trust-based scheme better than a GPP?**

- The regulator does not have a view on which type of scheme employers should offer. This is a decision for employers, which must be taken based on their own circumstances and objectives.
- The regulator's role is to protect work-based pension scheme benefits and promote and improve the understanding of good administration, regardless of the type of scheme.
- The government plans that with effect from 2012, all employers with employees earning over approximately £5,000 pa will be required to enrol them into a pension scheme of a prescribed standard.

As at present, it's proposed that it will be the employers' choice as to what pension scheme to offer employees, with the additional choice of a new personal accounts scheme for those employers not wishing to offer an alternative scheme.

### **Does the Pensions Regulator regulate AVCs?**

- AVCs are additional contributions paid by the members, to their occupational scheme. They may be applied to provide benefits on a 'money purchase' basis.

If they are paid to a DC scheme, they may be applied in a similar way to the members' defined contributions.

- Benefits derived from AVCs form part of the benefits of an occupational scheme and therefore fall within the scope of our statutory objectives.

This means that we are required to protect the benefits resulting from payment of AVCs and to promote and improve the understanding of good administration of AVCs.

- Our DC guidance is therefore of relevance to trustees and others involved with schemes providing DC AVCs.

- It's important that DC AVCs are not neglected by DB trustees, for example due to a focus on the funding of the DB section of the scheme. The governance standards of a DC AVC scheme should be as high as those of a DC-only scheme.
- We are aware that the AVC administrator is often different from the main scheme administrator, which introduces an additional complexity to the administration of such a scheme.

Trustees should ensure that communication channels are adequate to ensure good administration.

We do not regulate free-standing AVC schemes (FSAVCs) which are individual policies taken out by some members to top up their occupational scheme. These policies are regulated by the FSA ([www.fsa.gov.uk/Pages/Doing/Do/index.shtml](http://www.fsa.gov.uk/Pages/Doing/Do/index.shtml)).

### **Does the regulator treat group self-invested personal pensions (SIPPs) differently from ordinary GPPs?**

- A SIPP is essentially a personal pension offering wider investment choice than would normally be available in a personal pension.
- The legislative requirements for employers offering group SIPPs are the same as for employers offering standard group personal pensions.
- Aspects of group SIPPs which employers may wish to look at carefully are:
  - Member understanding – given the (often) wider investment choice under group SIPPs, are their employees equipped to make appropriate investment decisions?
  - Fit to workforce – how does the investment sophistication fit with the profile of the workforce, given the increased responsibilities on members due to the wider investment choice?
  - Charges – what are the charges and how do these compare with other SIPPs and GPPs ? Employers may wish to use the FSA comparison tables ([www.fsa.gov.uk/tables](http://www.fsa.gov.uk/tables)) which show the differing charges from providers of personal pensions and stakeholder pensions.
- The greater complexity of SIPPs is likely to be reflected in a more sophisticated voluntary governance arrangement by employers who want to monitor the effective operation of the scheme.

If you have a SIPP, or if you're considering introducing one, you should refer to our guidance on voluntary employer engagement ([www.thepensionsregulator.gov.uk/employers/engagement/erEngagement-01.aspx](http://www.thepensionsregulator.gov.uk/employers/engagement/erEngagement-01.aspx)) in work place contract-based pension schemes.

- The FSA has provided some commentary for financial advisers ([www.fsa.gov.uk/pubs/newsletters/fa\\_newsletter10.pdf](http://www.fsa.gov.uk/pubs/newsletters/fa_newsletter10.pdf)) on the suitability of SIPPs.

### **What does the regulator expect of schemes which provide both DB and DC benefits?**

- Many schemes provide both DB and DC benefits. These may operate as separate sections or there may be an interaction between the benefit types, depending on the scheme design. A common type of dual benefit scheme is a DB scheme which also includes DC AVCs.
- Trustees of such schemes need to understand the requirements in respect of both types of benefit.
- This means that they're required to have broader knowledge and understanding requirements than trustees of schemes only including one benefit type. The requirements are set out in our scope guidance ([www.thepensionsregulator.gov.uk/codesOfPractice/tku/tku-05.aspx](http://www.thepensionsregulator.gov.uk/codesOfPractice/tku/tku-05.aspx)).
- It's important that a member with DC benefits can expect the same high standards of governance regardless of whether the scheme provides DC benefits only or also provides DB benefits.

For example, whilst DB funding issues rightly demand a lot of attention from the trustees, they should ensure that any DC benefits in the scheme continue to be well-run.

- Where a scheme includes both DB and DC benefits, occasionally, the scheme rules may be drafted in such a way that, in certain circumstances, the DC benefits could be used to make up any shortfall in DB benefits in certain circumstances.
- Trustees of such a scheme may wish to consider with the employer whether to segregate the two sections and ensure that any possible impact on the DC benefits is adequately communicated to members.

## **Governance**

What does the regulator expect of those who run pension schemes?

Should we set up a management committee for our GPP?

How do we set up a management committee for our GPP?

What actions does the regulator expect schemes to take in response to legislation that abolishes contracting out by DC schemes?

What impact will personal accounts have on existing DC schemes?

### **What does the regulator expect of those who run pension schemes?**

- The regulator's view is that members are entitled to expect a scheme to be well-run and this applies whether it is contract-based or occupational.
- Trustees play a vital role in the governance of occupational pension schemes. The regulator's medium term strategy described our desired longer term outcome which is to have in place well-informed, capable trustees acting in the best interests of their members.
- The regulator also expects to see good governance standards on GPPs.
- We provide a wide range of materials to help those running schemes. If you haven't yet familiarised yourself with our training and guidance on DC, you can start by having a look at:
  - the DC module in the Trustee toolkit;
  - good practice guidance on retirement options and the open market option; and
  - employers who have group personal pensions or stakeholder pensions may refer to our guidance on employer engagement.
- For more information on our approach to governance, you can see our discussion paper on governance and the regulator's response 'How the regulator will promote better governance of work-based pension schemes.'

### **Should we set up a management committee for our GPP?**

- We believe it's in members' interests if all employers with a group personal pension or stakeholder scheme arrange for key aspects of its governance and investments to be reviewed periodically.
- Many employers also see benefits for themselves in carrying out a review.

For example:

- a scheme with good investment options and good governance is likely to be a more highly valued staff benefit; and
- it may be effective in mitigating potential risks to the employer (eg by preventing administration errors that could be costly to detect and correct at a later date).
- Any governance arrangement over and above meeting basic legal obligations, for example paying contributions on time, is voluntary for employers. Our guidance does not add to these obligations.
- There is no one-size-fits-all approach to reviewing a personal pension or stakeholder scheme. It is for employers to decide what type of governance structure works best for them – examples include:
  - a management committee;
  - their financial adviser;
  - involving employee representatives; and
  - involving the trustees of any existing occupational scheme (such trustees need to be mindful of their fiduciary duties to members of the occupational scheme and aware of any potential conflicts).
- Our qualitative research in 2007 found that a significant proportion of all employers with a GPP had some form of governance arrangement in place, albeit some were very informal.

We expect that figure to grow as employers realise the value of having a mechanism to ensure that their scheme continues to operate efficiently and be fit for purpose.

- Our guidance on voluntary governance arrangements ([www.thepensionsregulator.gov.uk/pdf/TPR\\_FSAguideOnRegulationOfCBschemes.pdf](http://www.thepensionsregulator.gov.uk/pdf/TPR_FSAguideOnRegulationOfCBschemes.pdf)) in GPPs includes case examples.

### **How do we set up a management committee for our GPP?**

- Any governance arrangement over and above meeting basic legal obligations, eg paying contributions on time, is voluntary for employers. Our guidance does not add to these obligations.
- There is no one-size-fits-all model for management committees so employers who decide that a management committee is the best approach for them can choose a structure suited to their own circumstances.
- Many employers issue terms of reference to their committee to clarify their remit.

- Employers often ask management committees to review scheme administration, investment practices and options, and member communications and report back to them with recommendations.
- Find out more in our guidance on voluntary governance arrangements ([www.thepensionsregulator.gov.uk/employers/engagement/erEngagement-01.aspx](http://www.thepensionsregulator.gov.uk/employers/engagement/erEngagement-01.aspx)) in GPPs which includes case examples and specimen terms of reference.

**What actions does the regulator expect schemes to take in response to legislation that abolishes contracting out by DC schemes?**

- The government proposes ([www.hmrc.gov.uk/pbr2007/pbrn1.pdf](http://www.hmrc.gov.uk/pbr2007/pbrn1.pdf)) that from a date to be announced, likely to be 2012, employers will no longer be able to use their occupational DC scheme to contract out of the state second pension.

Members of GPPs also will not be able to use their GPP to contract out of the state second pension.

- The regulator is part of a working group set up by the Department for Work and Pensions and HM Revenue and Customs (HMRC) with representatives from industry to look at what the cessation of contracting-out will mean for pensions and, in particular, how to communicate these changes.

**What impact will personal accounts have on existing DC schemes?**

- Personal accounts are intended to reach those employees without access to an existing scheme - therefore legislation (<http://services.parliament.uk/bills/2007-08/pensions.html>) has been constructed by government so that employers may continue to offer pension provision through existing DC and other schemes.
- Such existing schemes would need to meet certain qualification criteria (eg contribution rate, auto-enrolment).
- As at present, it's proposed that it will be the employers' choice as to what pension scheme to offer employees, with the additional choice of a new personal accounts scheme for those employers not wishing to offer an alternative scheme.

## **Administration**

Why is the regulator interested in promoting good administration?

How do we make sure that our scheme is well-administered?

What action does the Pensions Regulator take on the late payment of contributions by employers?

What is the employer's role in ensuring good administration?

What are the main aspects of administration where the regulator wants to see some overall improvement?

### **Why is the regulator interested in promoting good administration?**

- The regulator has been given a statutory objective to promote, and improve understanding of, good administration.
- Poor administration can mean members do not receive correct and timely benefits and also can cause delays if the scheme comes to be wound-up. Members themselves may not realise that mistakes have occurred.
- Our business plan for 2008/9 ([www.thepensionsregulator.gov.uk/pdf/CorporatePlan2008.pdf](http://www.thepensionsregulator.gov.uk/pdf/CorporatePlan2008.pdf)) includes an objective that “scheme administration is improved as a result of the regulator’s actions”.

The performance indicator for this objective is that “standards for effective record-keeping have been identified, consulted upon and implemented where appropriate, and results of the annual governance survey show sustained performance in the following areas:

- risk management
  - internal controls
  - administration service standards”
- In relation to the administration of GPPs, we liaise closely with the FSA who also has regulatory responsibility for the administration of GPPs.

### **How do we make sure that our scheme is well-administered?**

- We expect trustees to work with their administrators to verify the quality of record-keeping and to put in place an action plan to correct any data problems that are identified.

#### **Occupational schemes**

- Key to good administration is an open and honest relationship between the trustees and administrator, so that any issues are quickly identified which means that swift action can be taken to address them.

- In relation to administration for schemes with AVCs, it's important to consider the administration of the AVC benefits as well as the main scheme benefits.
- Administration is covered in the Trustee toolkit and the regulator's code of practice on internal controls.

#### GPPs

- In relation to the administration of GPPs, we liaise closely with the FSA who also has regulatory responsibility for the administration and systems and controls of GPP providers.
- Our guidance on voluntary employer engagement includes monitoring administration.
- There is no 'off-the-shelf' answer to how trustees and employers can ensure their scheme is well-administered as it will depend on how the scheme has been set up and what the trustees and employer want to achieve.

Therefore those running schemes need to take an intelligent scheme-specific approach. Our governance survey indicates a high correlation between the level of training that trustees have received and the standards of scheme governance.

#### **What action does the Pensions Regulator take on the late payment of contributions by employers?**

- The prompt and accurate payment of contributions by the employer is vital under both occupational DC schemes and GPPs, as the timing and amount of contributions determine the investments purchased for members.
- The primary responsibility to recover unpaid contributions falls to trustees (occupational schemes) and providers (GPPs).
- Under the regulator's codes of practice for reporting late payment of contributions, any late payment which is likely to be of material significance to the regulator should be reported to us by the trustee/manager.
- The regulator will take action to recover contributions in some cases of late payment in accordance with its risk-based approach. Due to the large number of DC schemes, the regulator has to prioritise the reports it receives, focusing on those where the impact to the members is greatest.
- Member complaints regarding late payments by employers can also be referred to the Pensions Advisory Service ([www.pensionsadvisoryservice.org.uk/](http://www.pensionsadvisoryservice.org.uk/)).

## **What is the employer's role in ensuring good administration?**

- The successful administration of occupational DC schemes normally involves the employer at all stages of the member life cycle; joining, during active membership, leaving service and retirement.

Under GPPs, where the member leaves service prior to retirement, the employer may no longer have a role in administration.

- The employer needs to provide accurate and timely employee data to the scheme administrator.
- Periodic reconciliation of employee data with member data is likely to be essential to ensure the ongoing accuracy of member records.
- The employer benefits from active engagement in scheme administration as poor administration can be costly to put right.
- Our guidance on voluntary employer engagement includes the administration of GPPs.

## **What are the main aspects of administration where the regulator wants to see some overall improvement?**

- As outlined in its business plan, the regulator has identified two priority areas for administration - effective record-keeping and reducing the time taken to wind up schemes – as there are issues across the industry.

It's important, however, that each scheme and provider looks at their own scheme to identify the specific areas where they need to consider improvements.

- On trust-based schemes, the trustees retain responsibility for administration even though the actual work is generally delegated.
- We see record-keeping as a key part of good administration and we plan to consult on our approach to the quality of record-keeping by all pension schemes including DC schemes.
- We expect to see the wind-up of occupational schemes completed in two years, and have issued a consultation document setting out our expectations. We've also issued an e-learning module on winding up in the Trustee toolkit.
- The Trustee toolkit covers key aspects of administration.

## **Investment**

Why is the regulator interested in improving investment practices?

Will the regulator be issuing guidance on the investment strategy schemes should follow?

Do DC schemes offer members too many fund choices?

What sort of default fund should we offer to the members of our occupational scheme?

What is the regulator's attitude to poor investment performance by DC schemes?

### **Why is the regulator interested in improving investment practices?**

- In a DC scheme, the return a member receives on their pension fund is one of the key factors that will determine the sum available at retirement, which in turn will determine the member's retirement income.
- In general, an employer with a DC scheme is not required to make up any shortfall in funds required to provide expected benefits, as would be the case in a DB scheme, so it's important for the member to make the most of the contributions paid to the scheme.
- Key decisions to be made include the:
  - selection of investment manager(s);
  - selection of range of funds to be made available; and
  - choice of fund(s) by members.
- A lack of familiarity with investments may mean that many members are not well-placed to make investment decisions, without some support.
- This all adds up to the fact that if members' benefits are to be protected, it is particularly important that everyone involved in running DC schemes maintains a high standard of vigilance where investments are concerned.

### **Will the regulator be issuing guidance on the investment strategy schemes should follow?**

- We will not be dictating to trustees or any other party how to fulfil their responsibilities in relation to setting their investment strategy.
- In a contract-based scheme such as a GPP the employer and the scheme provider share some responsibilities for selecting the investment choices to be made available to members.
- Decisions by those running schemes should be appropriate for the membership and due processes should be in place to help ensure that the roles and

responsibilities of different parties are properly carried out and that relevant internal controls are in place.

Key issues for trustees and providers to focus on are their processes for appointing and monitoring investment managers and the range of funds they make available to members.

- We're considering whether it would be beneficial to issue guidance on investment practices such as the selection of investment managers and fund choices.
- In a trust-based scheme, it's for schemes to determine their investment strategy based on their own circumstances, taking into account factors such as the membership profile and the scheme rules.

This means that although members have the ultimate responsibility to choose from among the funds on offer, trustees have responsibility for determining the overall strategy and the funds to be offered.

- The Trustee toolkit contains a module covering investment issues for DC schemes.
- On GPPs, the FSA rules and principles ([www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml](http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml)) include the principle that providers must treat customers fairly which includes guidance on product design and communications.
- The regulator is involved in the review of the Myners report ([www.hm-treasury.gov.uk/consultations\\_and\\_legislation/myners/consult\\_myners\\_index.cfm](http://www.hm-treasury.gov.uk/consultations_and_legislation/myners/consult_myners_index.cfm)) on investment practices.

### **Do DC schemes offer members too many fund choices?**

- In practice, most members do not require a large number of funds to choose from. There is evidence that increasing fund choice discourages employees from joining schemes as they are overwhelmed by the choice.

The Pensions Institute's report 'Dealing with the Reluctant Investor' ([www.pensiondcisions.com/admin/files/Pensions%20Institute%20extract%20-%20Dealing%20with%20Reluctant%20Investor%20Apr07.pdf](http://www.pensiondcisions.com/admin/files/Pensions%20Institute%20extract%20-%20Dealing%20with%20Reluctant%20Investor%20Apr07.pdf)) shows evidence that large numbers of members do not actively consider alternative funds if a default fund is provided.

However, the regulator is not setting a minimum or maximum number of funds that schemes offer or suggesting whether it is good practice to offer a default fund.

- The number and risk profile of funds on offer should reflect the nature of the membership – especially their level of financial capability.

- Where there is a greater number of funds, this points to a need for greater support for members to make an informed decision due to poor member understanding.
- On GPPs, the FSA rules and principles ([www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml](http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml)) include the principle that providers must treat customers fairly which includes guidance on product design and communications.

### **What sort of default fund should we offer to the members of our occupational scheme?**

- It is not for the regulator to determine the investment strategy that schemes should adopt and we are not currently planning to provide guidance on the choice of a default fund.
- Schemes other than stakeholder pensions, are not subject to any requirement to offer a default fund. The number and types of funds offered should be matched to the profile of the scheme's membership, especially their financial capability.
- Any default fund should be reviewed regularly as should other funds offered to members.
- Our Trustee toolkit provides help for trustees in the selection of funds.
- Evidence suggests that where a default fund is offered, the majority of members are likely to use that fund to accrue their benefits. This means that the design and monitoring of this fund may be of particular importance to members.

If you want to explore this subject further you could have a look at:

- Recent research by PensionDCisions ([www.pensiondcisions.com/contact/survey.php](http://www.pensiondcisions.com/contact/survey.php)) which demonstrates the wide difference in the returns of default funds; and
- The Pensions Institute report, 'Dealing with the Reluctant Investor' ([www.pensiondcisions.com/admin/files/Pensions%20Institute%20extract%20-%20Dealing%20with%20Reluctant%20Investor%20Apr07.pdf](http://www.pensiondcisions.com/admin/files/Pensions%20Institute%20extract%20-%20Dealing%20with%20Reluctant%20Investor%20Apr07.pdf)) which also highlights some important issues.

### **What is the regulator's attitude to poor investment performance by DC schemes?**

- The rate of return on an investment can be determined by many factors, and our focus is around the processes followed by those running schemes rather than the absolute or relative investment returns in themselves.

- Given that members' benefits in a DC scheme are directly linked to returns on investments, the regulator may take action where it identifies inadequacies in a scheme's processes in relation to investment practices.

For example, appropriate care is not taken in the selection and review of the appointment of the investment manager.

- In an occupational scheme, trustees are required to follow certain processes, eg take professional advice and appoint an appropriately skilled person to invest contributions.

In practice, most schemes select investment managers regulated by the FSA. The FSA may act to redress shortcomings in particular where investments are not managed in line with mandates.

- In a GPP the FSA rules and principles ([www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml](http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml)) include a principle that providers must treat customers fairly which includes guidance on product design and communications.
- In a GPP, employers may wish to put in place arrangements to review investment issues. For example, they may decide to set up a management committee.
- The periodic review of both advisers and investment managers is important and is likely to reduce the potential for member dissatisfaction, as well as helping to ensure that the members' benefits are protected.
- We're considering issuing guidance to help trustees and employers with the process of selecting and reviewing investment managers and choosing an appropriate range of funds.
- Trustees may refer to the relevant module in the Trustee toolkit for information.

## **Charges**

What do you mean by 'charges'?

Why is the regulator interested in charges?

What would be a disproportionate charge and how does the Pensions Regulator propose disproportionate charges can be identified?

Does the regulator believe that those running DC schemes should focus on 'value for money' rather than absolute costs?

### **What do you mean by 'charges'?**

- Charges may take many forms and vary greatly from scheme to scheme, both in amount and in the way they are applied. The rules of an occupational scheme and the conditions of the contract in a GPP include the charges that can be levied.
- Charges that are applied to DC funds may include flat rate fees (eg a monthly policy fee unrelated to the fund size), deductions from the fund (eg the annual management charge is usually expressed as a percentage of the fund value), initial charges (eg set-up costs such as the bid-offer spread: the difference between the prices at which investments are bought and sold), exit charges (eg transfer fee if member transfers to a different scheme).
- In terms of our interest in charges, our focus is on charges which impact directly on members' benefits, although we recognise that expenses incurred in other areas are also significant.
- You can find more information about charges in our Trustee toolkit.

### **Why is the regulator interested in charges?**

- Charges are a key factor in determining the level of a member's benefits.
- The regulator wishes to see that:
  - charges are taken into account, for example when investment managers are selected and when the range of fund choices is determined;
  - members receive an explanation of charges that may affect decisions that they need to make; and
  - charges are kept under review.
- We recognise that members sometimes derive benefits in ways that are not easily valued such as education, access to advice or clarity of communications.

We therefore have no plans to provide guidance on what level of charges might be acceptable.

## **What would be a disproportionate charge and how does the Pensions Regulator propose disproportionate charges can be identified?**

- Schemes have a wide variety of benefits and charging structures. Furthermore, members sometimes derive benefits in ways that are not easily valued, such as education, access to advice or clarity of communications.

It's not therefore feasible to define a level of charges which is appropriate in all cases and we have no plans to provide guidance on what level of charges might be acceptable.

- The only schemes where charges are subject to a statutory limit are stakeholder pensions.
- Trustees of occupational schemes should consider whether charges are reasonable when compared to the benefits members receive in return. We would hope that in a GPP an employer would have a similar interest in obtaining value for money.
- If charges under an occupational scheme appear to be disproportionate, the regulator may raise the matter with the trustees.

For example, the regulator has taken action to reduce costs incurred by schemes in winding up.

- We expect that charges that may affect decisions that members need to take are transparent to members.
- In GPPs, the FSA rules and principles ([www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml](http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml)) include a principle that providers must treat customers fairly which includes guidance on product design.
- We would work closely with the FSA in the case of charges by providers of GPPs appearing to be disproportionate.

## **Does the regulator believe that those running DC schemes should focus on 'value for money' rather than absolute costs?**

- Trustees of occupational schemes should seek to obtain value for money on behalf of members.
- We are not saying that cheaper is better, but that those with responsibility for decisions that have an impact on the cost of running a scheme and on the charges a member will have to pay give due consideration to the members' interests.
- Schemes have a wide variety of benefits and charging structures. Trustees of occupational schemes should consider whether charges are reasonable when looked at in comparison to the benefits members receive in return.

We would hope that in a GPP an employer would have a similar interest in obtaining value for money.

- It should be recognised too that members sometimes derive benefits in ways that are not easily valued.

Obtaining 'value for money' means looking at the overall package being offered by a service provider – for example, the quality and nature of communications to members; the level of investment returns; frequency of meetings; quality of reporting; effectiveness of service delivery.

- It's not feasible to define a level of charges which is appropriate in all cases and the regulator will not be providing guidance on what level of charges might be acceptable.
- Trustees of occupational schemes should consider whether charges are reasonable when looked at in comparison to the benefits members receive in return.
- In a GPP, we encourage the employer to become involved in considering the charges when selecting and reviewing a GPP provider.

There's more information on this in our guidance on voluntary employer engagement in GPPs. Employers may wish to use the FSA comparison tables ([www.fsa.gov.uk/tables](http://www.fsa.gov.uk/tables)) which show the differing charges from providers of personal pensions and stakeholder pensions.

## Retirement

Why is the regulator focusing on retirement issues?

Should members be given financial advice at retirement, given the important decisions they need to make regarding their retirement income?

How can employers or trustees provide information that will help the member at retirement?

Why is the regulator getting involved in this area? I thought the joint review of the open market option by the Treasury & DWP took care of this issue?

What is the regulator's view regarding the alternatives to an annuity now available to members at retirement?

As trustees, why should we offer a good annuity when our members can use the open market option?

### Why is the regulator focusing on retirement issues?

- At retirement, the majority of members will want to convert their money purchase funds into a retirement income. We focus on the retirement process because of the following reasons:
  - The decisions made at retirement are irreversible and will impact on the income received by members and their dependants for the rest of their lives. So it's important to get it right.
  - Retirement decisions are complex, involving a consideration of both the type of annuity and the choice of a provider who will offer the best level of income.
  - Indications are that shopping around for an annuity can often produce a significantly better benefit.
  - This is an area where there is much innovation in the market which is adding to the complexity for members. Current products include: impaired life annuities, with profit annuities, unit linked annuities, unsecured pension arrangements and alternatively secured pension income.
  - You can find a description of different kinds of products in the Trustee toolkit.
  - Schemes offer different levels of support for members in choosing their benefits and we are keen to encourage trustees to emphasise the advantages of obtaining financial advice from an appropriately authorised adviser, particularly where a number of options are available.
- Our research suggests some scheme trustees are unaware of the need to offer the open market option (OMO) before a pension starts. There could be serious adverse tax consequences for the member if they are not made aware that they have the right to select a provider.

- The regulator's work supports the Government's long term strategy to increase financial capability in the UK and to boost understanding of financial issues arising from pension saving, as set out in the HM Treasury report 'The Annuity Market' ([www.hm-treasury.gov.uk/media/9/6/pbr06\\_annuities\\_293.pdf](http://www.hm-treasury.gov.uk/media/9/6/pbr06_annuities_293.pdf)).

**Should members be given financial advice at retirement, given the important decisions they need to make regarding their retirement income?**

- There is no legal requirement to give access to financial advice. However, where members do get advice from an appropriately authorised adviser, they will be given an explanation of the options that apply to them.
- In addition, if anything goes wrong, they will have some protection under the FSA's rules.

The regulator encourages trustees and employers to:

- have an understanding of the process and the issues that can arise so that they can question their advisers and determine the best approach for their scheme and its membership; and, importantly
- emphasise the advantages of obtaining financial advice from an appropriately authorised adviser, particularly where a number of options are available.
- You can find out more in:
  - our Trustee toolkit where there's information about the provision of access to financial advice; and
  - our good practice guidance on retirement options where we describe some typical strategies that trustees might consider adopting to support the member at retirement.
- Where there are no arrangements in place to provide members with individual advice, schemes can provide support by directing members to the generic advice available from:
  - our guidance on retirement choices: ([www.thepensionsregulator.gov.uk/pdf/retirementChoices2006.pdf](http://www.thepensionsregulator.gov.uk/pdf/retirementChoices2006.pdf))
  - the Pensions Advisory Service website: ([www.pensionsadvisoryservice.org.uk/](http://www.pensionsadvisoryservice.org.uk/))
  - the FSA website: ([www.moneymadeclear.fsa.gov.uk/](http://www.moneymadeclear.fsa.gov.uk/))

Members who want to find an adviser may be referred to [www.unbiased.co.uk](http://www.unbiased.co.uk). There is usually a cost for the provision of financial advice, which may be met by the member or employer.

## **How can employers or trustees provide information that will help the member at retirement?**

- If an occupational scheme provides benefits on a DC basis, trustees must ensure that there is an efficient process in place to convert the member's money purchase fund into a retirement income.
- We're keen to encourage employers or trustees to ensure that members or dependants have the best opportunity to choose a type of annuity that is suitable for them and provides the best level of benefit.

They should choose the most suitable approach bearing in mind the needs of their members and the circumstances of the scheme.

- You may want to refer to our retirement options guidance where you can see an overview of the process and some good practice strategies.
- Where there are no arrangements in place to provide members with individual advice you can consider providing support for members by:
  - directing them to the FSA comparative tables for annuities
  - suggesting they consider making use of the new annuity tool on the TPAS website ([www.pensionsadvisoryservice.org.uk/](http://www.pensionsadvisoryservice.org.uk/)); and
  - referring them to our retirement options guidance ([www.thepensionsregulator.gov.uk/pdf/retirementChoices2006.pdf](http://www.thepensionsregulator.gov.uk/pdf/retirementChoices2006.pdf)) written for members.

Members who want to find an adviser may be referred to [www.unbiased.co.uk](http://www.unbiased.co.uk).

- Those employers with GPPs that want to get more involved in the governance of their scheme can find more information in our guidance on employer engagement ([www.thepensionsregulator.gov.uk/employers/engagement/index.aspx](http://www.thepensionsregulator.gov.uk/employers/engagement/index.aspx)) in GPPs.
- We're also committed to issuing guidance including good practice examples on communicating with members in the period leading up to retirement.

## **Why is the regulator getting involved in this area? I thought the joint review of the open market option by the Treasury & DWP took care of this issue?**

- The regulator participated in the review of the open market option (OMO) led by the Department for Work and Pensions (DWP) and HM Treasury in 2007.

The following initiatives came out of it:

- The FSA is reviewing the operation of the OMO and member communications for personal pensions.

- The Pensions Advisory Service has developed a new online annuity planner.
- The DWP will lead on facilitating the development of better-focused information on the lines of the structured choice approach.
- HM Treasury will report annually on how well the OMO is operating. View the HM Treasury report ([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)).
- The regulator's guidance is complementary to and supports the OMO review initiatives. We've produced good practice guidance for trustees of occupational schemes that:
  - helps to raise awareness of the need to offer the OMO at retirement;
  - emphasises the importance of schemes having an efficient process in place to convert money purchase funds into a retirement income;
  - recognises that different processes will suit different schemes; and, importantly
  - encourages trustees to emphasise the advantages of obtaining financial advice from an appropriately authorised adviser, particularly where a number of options are available.
- We're also committed to issuing guidance including good practice examples on communicating with members in the period leading up to retirement.

**What is the regulator's view regarding the alternatives to an annuity now available to members at retirement?**

- It's not for the regulator to say which retirement income products are appropriate for individuals. That decision rests with members and their advisers.
- It is, nevertheless, important for those running schemes to be aware that there is an increasing range of alternatives to conventional annuities (involving very different benefits and disadvantages) and where a choice is available, members are well advised to consider which type of retirement income product is suited to their circumstances.
- We welcome employer and trustee initiatives to make advice from a suitably authorised adviser available to members. Trustees do not have to advise members of all the alternatives available under the open market option, but they should be aware of the existence of alternatives so that they can judge what retirement process is appropriate for their scheme and its membership.
- We encourage trustees and employers to emphasise to members the advantages of taking advice from a suitably authorised adviser so that members are better able to make an appropriate decision based on their particular circumstances.

- You can read more about the ways schemes might consider providing support to members at retirement in our good practice guidance on retirement options.
- You may also like to refer to the DC module of the Trustee toolkit which describes the different types of retirement products commonly available.

**As trustees, why should we offer a good annuity when our members can use the open market option?**

- Although DC schemes are required to tell members about the open market option (OMO) and to give members the option to choose an annuity provider, there is no requirement for members to exercise the OMO.
- Many members who do not exercise the OMO (perhaps because they do not feel confident to do so, or because they cannot afford to pay for advice) will look to the trustees to provide an annuity for them.
- The regulator encourages trustees and employers to:
  - have an understanding of the process and the issues that can arise so that they can question their advisers and determine the best approach for their scheme and its membership; and, importantly
  - emphasise the advantages of obtaining financial advice from an appropriately authorised adviser, particularly where a number of options are available.
- Where, in an occupational scheme, members do not exercise the OMO, and scheme rules or practices require trustees to purchase an annuity for the member (or dependant), then trustees should have regard to the provisions of the scheme rules and to their duty to act in the best interests of members and other beneficiaries.
- Trustees might consider obtaining professional advice, if they think that appropriate, over the extent of their fiduciary responsibility to scheme members.

## Member understanding

Why is the regulator concerned about member understanding?

What action is the Pensions Regulator taking to improve member understanding?

As trustees, where can we get help so our members understand pensions issues better?

How can schemes make improvements to existing communications to members?

How can you expect trustees and providers to take responsibility for what members understand?

Do schemes have to make financial advice available to their members?

### Why is the regulator concerned about member understanding?

- Research has shown that many members may not have the necessary level of understanding to take the complex decisions required of them in DC schemes, for example how much to contribute and how to invest their contributions.

Participants have identified the need for greater engagement by members of DC schemes compared to DB schemes, where trustees take most of the difficult decisions.

- In general, an employer with a DC scheme is not required to make up any shortfall in funds required to provide expected benefits, as would be the case in a DB scheme.

As a result, the consequences of poor decisions by members will be fully borne by members themselves and it is important that they have the necessary level of understanding to take the decisions that are required of them.

- The following websites tell you more about member understanding:
  - the FSA report on financial capability ([www.fsa.gov.uk/financial\\_capability](http://www.fsa.gov.uk/financial_capability)) which highlighted the general low level of understanding of financial matters by the public.
  - the Thoresen report on generic advice ([www.hm-treasury.gov.uk/independent\\_reviews/thoresen\\_review/thoresenreview\\_index.cfm](http://www.hm-treasury.gov.uk/independent_reviews/thoresen_review/thoresenreview_index.cfm))
  - the regulator's Trustee toolkit, DC module.

### What action is the Pensions Regulator taking to improve member understanding?

- Our primary focus is on fulfilling our statutory objectives through our three-pronged approach:
  - providing education and guidance to those involved in running schemes;

- working in partnership with the pensions industry and relevant public bodies; and
- intervention proportionate to the level of risk.
- We're working with others with responsibilities in this field, for example the FSA, DWP and TPAS, to work out how we can best add value in terms of direct communications with members.
- We're also planning to issue some good practice guidance on member communications which will encourage those responsible for member communications to consider how they can make them as effective as they can in order to help member understanding.
- Members have other organisations to which they can turn for help and advice.

These include:

- The Pensions Advisory Service (TPAS):  
[www.pensionsadvisoryservice.org.uk/](http://www.pensionsadvisoryservice.org.uk/)
- FSA Moneymadeclear : [www.moneymadeclear.fsa.gov.uk/](http://www.moneymadeclear.fsa.gov.uk/)
- To find an IFA:  
[www.unbiased.co.uk](http://www.unbiased.co.uk)
- There are plans that the money guidance service recommended by the Thoresen report [([www.hm-treasury.gov.uk/independent\\_reviews/thoresen\\_review/thoresenreview\\_index.cfm](http://www.hm-treasury.gov.uk/independent_reviews/thoresen_review/thoresenreview_index.cfm))] will be made available to pension scheme members in coming years.
- These public sector initiatives can play a valuable role in giving members generic information, but they generally do not provide information on the member's own scheme.
- We therefore encourage those running schemes to take the level of member understanding into account in scheme design and communications.

Communications and the scheme documentation should be designed to be understood by the membership.

- On GPPs, the FSA rules and principles ([www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml](http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml)) include a principle that providers must treat customers fairly which includes how products are communicated.

## **As trustees, where can we get help so our members understand pensions issues better?**

- There are numerous sources of information on member communications. Here are some examples:
  - Moneymadeclear ([www.moneymadeclear.fsa.gov.uk/](http://www.moneymadeclear.fsa.gov.uk/))
  - Institute of Personnel and Development report 'Pensions Communications: realising the value' ([www.cipd.co.uk/NR/rdonlyres/26920B07-E574-4589-9AD5-E74B90866237/0/pensionscomms.pdf](http://www.cipd.co.uk/NR/rdonlyres/26920B07-E574-4589-9AD5-E74B90866237/0/pensionscomms.pdf))
  - The regulator's Trustee toolkit
- You may wish to consider discussing your concerns with your advisers as there is a vast range of imaginative communication methods now available that can be tailored to the needs of different schemes.
- We propose to issue guidance including good practice examples on the more challenging areas of member communications.
- One tool that some schemes have found valuable is surveys of their members to identify those areas where more assistance is most needed and how that assistance can best be delivered.

## **How can schemes make improvements to existing communications to members?**

- Member communications can sometimes be one of the biggest challenges facing a DC scheme. We've talked to many trustees and employers who would like to make improvements to their existing communications but find this difficult for a variety of reasons.
- A key step is to decide on the aspects where improvements are required (eg take-up, contribution level, fund choice, retirement options), and agreeing the desired outcomes. Identifying barriers to achieving those outcomes can then point the way to a possible solution.
- Communications to members must comply with the relevant disclosure regime and we will be encouraging those responsible for member communications to consider how they can make them as effective as they can in order to help member understanding.

## **How can you expect trustees and providers to take responsibility for what members understand?**

- The regulator does not impose any additional requirements over and above the legal requirements that already exist.

- Whilst member understanding may ultimately be the responsibility of the member, we encourage schemes to consider how they can maximise the effectiveness of their communications to make it easier for members to understand, as improving member understanding is one of the key challenges facing schemes.
- Trustees have a statutory responsibility to comply with the disclosure requirements and they must also observe the scheme rules and any other legal duties they may have.
- Providers must comply with the disclosure regime that applies to the type of contract in question and they must also observe the requirements of the FSA's requirements for 'Treating Customers Fairly' ([www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml](http://www.fsa.gov.uk/Pages/Doing/Regulated/tcf/index.shtml)).
- Many of those running schemes have recognised that it benefits them as well as members if there is improved member understanding. For example, greater appreciation of the benefits of the scheme; more members have realistic expectations as to the level of income they will have in retirement so they are not surprised when they reach retirement age.

### **Do schemes have to make financial advice available to their members?**

- There is no legislative requirement to make financial advice available to members of DC schemes.

However, many schemes decide to assist members in obtaining financial advice as they recognise that the decisions to be made are complex (for example, how much to contribute; what fund to invest in) and many members require support.

- We encourage schemes to recognise and emphasise to members the advantages of obtaining financial advice during the scheme lifecycle (joining, periodic reviews, on leaving, at retirement) due to the importance of the decisions required throughout their membership.
- Where members do take financial advice from an adviser regulated by the FSA they will have some protection under the FSA's rules.
- Our Trustee toolkit includes the message to trustees that they should discuss providing members with access to financial advice.
- Some schemes provide other forms of support that stop short of regulated financial advice, for example online planners; workplace presentations, scheme newsletters.
- To find an independent financial adviser, a member can visit [www.unbiased.co.uk](http://www.unbiased.co.uk). There is usually a cost for the provision of financial advice, which may be met by the member or employer.

- The Pensions Advisory Service ([www.pensionsadvisoryservice.org.uk](http://www.pensionsadvisoryservice.org.uk)) provides a service offering advice in the workplace that trustees and employers may wish to consider.