



Independent Trustees



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Will contract-based pension schemes be required to have independent governance boards?



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The drive for higher standards of governance for defined contribution (DC) pension schemes is clear, and it is coming from all sides.

With the multitude of reforms put forward by Steve Webb, the pensions minister, and new guidance issued by the Pensions Regulator (the Regulator), it can be difficult to keep up with all the new requirements and proposals. The shadow pension minister, Gregg McClymont, has also been vocal on DC governance.

Independent trustee boards for contract-based schemes?

Following a suggestion by Gregg McClymont at last year's National Association of Pension Funds (NAPF) annual conference, Labour recently reiterated their commitment for all qualifying workplace schemes (including group personal pensions) to be overseen by independent trustee boards. They have concerns that the commercial interests of the owners or shareholders of organisations with contract-based schemes are being put ahead of members' interests.

Independent trustee boards with a fiduciary duty to members are seen as a possible solution to this governance gap. Aside from the fact that there can be no trustee without a trust, the principal role and responsibilities of a trustee do translate easily across into contract-based schemes.

The proportion of employers who have established a governance committee to oversee their contract-based scheme has increased significantly in recent years.

Appointing an independent trustee (albeit in a non-trustee capacity) with many years' experience of managing schemes and acting in the best interest of members **could be extremely beneficial.**

The same old issues...

Labour's major concerns include high charging structures and members purchasing poor value annuities at retirement. It is true that some historic contract-based schemes have funds with high charging structures. However, changes in regulation, increased competition and significant advancements in technology have ensured newer products are far better value for money.

I believe the **most important challenge is to ensure members are properly informed** about their options when they reach retirement – and that this flow of information happens throughout their pension membership.

Where there is no active adviser in place, contract-based scheme members are typically left to their own devices. Many are just confused and simply accept an annuity from the scheme's insurer, which may not be the best available – in fact, it rarely is. The flexibility proposed in the Budget, to allow members to take their entire DC fund as cash at retirement, will create even more confusion and increase the risk of poor decision making. Along with the proposed 'guidance guarantee', if the introduction of independent governance committees can improve member understanding and help them make properly informed decisions, this will be a good outcome.

I should add that **trust-based DC schemes are not immune to this problem**. Although many use an annuity broker to help members use their open market option to find the best annuity, not all do. Trust-based schemes are also equally open to suffering as a result of insufficient or ineffective member communications.

Labour's proposal is adding to the pressure on government to ensure high standards of governance for DC schemes as more and more workers are automatically enrolled.

New regulatory requirements for trust-based DC schemes

One recent development is the Regulator's code of practice and guidance published in November 2013. This sets out 31 quality features that should be present in occupational (trust-based) DC schemes. To show their scheme complies, **trustees are expected to publish a governance statement each year**, and make it available to members and employers.

At first glance, checking compliance with 31 quality features and putting in place plans to close any gaps might appear an onerous and expensive task. However, the guidance is based on existing legal requirements so well run schemes should not have to implement wholesale changes in order to comply. Our view is that the **size of scheme and governance budget should be taken into consideration** when undertaking a review of its governance standards.

What could the regulatory future be for contract-based schemes?

The Regulator's new DC code of practice and guidance does not cover contract-based schemes. However, the **government are investigating how governance committees can sensibly work for contract-based schemes**. If they become a regulatory requirement, could the next step be guidance similar to that for trust-based schemes?

In response to a Work and Pensions Select Committee report, the government noted there are challenges with having employer specific governance committees for group personal pensions (GPPs). It may not be practical or economic for all employers, particularly small ones, to have a governance committee, so they are **exploring alternative options**. For example, the governance committee could be at provider level, or some intermediate arrangement. However, they have made it clear that employers who wish to set up a governance committee should continue to do so.

Labour's proposals require the oversight board to be independent. Unfortunately, there are not enough experienced professional trustee companies to meet the demand if all employers' DC schemes were required to have independent oversight. Having an independent board at provider level rather than for every employer would ease this problem, but could result in a reduction in the number of providers in the market.

It is clear that recent developments highlight that the governance of both trust and contract-based DC schemes is coming under greater political and regulatory scrutiny. I say hold on to your hats as, whatever the future holds, I expect the wind of change to be even stronger in the coming few years.

What do you think?

Share your thoughts with us,
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