DC research response

September 2018

The Pensions Regulator

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We aim to ensure that all pension schemes we regulate are well run, provide good value and are well-funded, so their members get the benefits they reasonably expect.

To understand the extent to which trustees meet the expectations we set out in our defined contribution (DC) governance and administration code of practice and related guidance, and what barriers trustees face in running their schemes, we undertook a survey of DC schemes in spring 2018. The survey covered DC code expectations, scheme governance requirements and awareness, and the action trustees took as a result of our 21st century trusteeship campaign. This campaign was launched last year to help trustees raise their standards of governance. The survey follows similar studies carried out in previous years. In particular, we have compared this year's results with those of 2017, meaning that we can identify trends.

The headline results for each of these areas are as follows:

Governance requirements

The survey shows some improvements in DC governance and administration, with over half of DC members in schemes that meet all their key governance requirements. However, this is mainly attributable to larger schemes and the fact that there are more members in master trusts than in 2017. Although the number of micro schemes that meet all the requirements has increased since last year, it is still disappointingly low. This segment of schemes gives us particular cause for concern.

DC code expectations

The results were similar for meeting DC code expectations. A greater number of the large and medium schemes are meeting our expectations although investment governance was the worst performing area across all schemes.

21st century trustee campaign

The aim of this campaign, launched in September 2017, is to raise standards of scheme governance, focusing on the fundamental governance elements required across all schemes. At the time of the DC survey, five of the ten planned 21st century campaign themes had been communicated through targeted emails to those involved in pension schemes such as trustees, scheme managers, employers and advisers. The vast majority of micro schemes took no action as a result of receiving the 21st century trusteeship communications and only about half of small schemes took any action. The most common reasons given for this were that trustees felt they did not need to take any action, they did not believe it was relevant to their scheme, or they had other priorities.

Key findings from the survey are highlighted in the attached annex, along with our expectations for each area.

Overall the results are fairly similar to last year. Larger schemes, particularly master trusts, are on the whole well run. However, we still have concerns about the long tail of small DC schemes which our research continues to show are sub-standard. This is in spite of our 21st century communications which aimed to clarify our expectations and help trustees of small schemes to focus on the activities that would improve outcomes for their members.

We have also carried out a thematic review of small and micro schemes in order to gain a better understanding of the action they are taking to ensure that their schemes offer value for members. The findings, which are being published in conjunction with this survey, indicate that most small and micro trustees are struggling to carry out this requirement.

The following section sets out the action we propose taking over the next year to address the issues regarding smaller schemes.

Clear expectations and quicker, tougher action

We recognise that the trustee role is challenging and we will continue to support trustees, particularly in smaller schemes, to meet the standards we expect.

However, it is clear from the 21st century trustee campaign, the value for members thematic review and the results from this survey that a number of small and micro schemes are still not meeting the standards we expect and are unlikely to be providing good value for their members.

The fundamentals of good governance covered in our 21st century trusteeship campaign are required of all schemes, regardless of size or status. However, the main reason for this segment of schemes failing to meet our standards appears to be that the trustees do not believe that our expectations apply to their scheme.

We are already changing the way we engage with this hard-to-reach group, and over the past year have continued to take enforcement action against schemes failing in their basic governance duties. We will be more directive with the trustees of this segment of schemes and communicate with them in a way that sets very clear expectations about the action they need to take across a wider range of governance duties.

Starting with on the theme of poor investment governance, we intend to pilot a regulatory approach ensuring that members are in schemes where default strategies are properly governed. We will target tailored communications to certain DC trustees, setting out what we expect them to do in reviewing their default fund strategy and follow this up with interventions to ensure the reviews meet our expectations.

The DC chair's statement continues to be a key tool for trustee boards to focus on their governance and administration and provides members with important information, for example on costs and charges. However, we continue to come across statements of varying quality. Last year we produced a quick guide to what a good chair's statement looks like to help the trustees of DC schemes meet the standards set out in legislation.

We have recently updated this to reflect our more recent casework experience, adding a new section covering common mistakes for trustees to avoid. We will continue to take action against schemes that produce sub standard statements. Trustees of DC schemes can expect increased scrutiny from TPR as part under our proactive and supervisory approach to regulation. They can also expect to see TPR and the FCA working together more closely to ensure that the risks to members of DC schemes, both occupational and contract-based, are identified and addressed consistently.

Professional trustees

Professional trustees continue to play an important role in the DC landscape, so we will continue to focus on making sure they meet the higher standards we expect. The Professional Trustee Standards Working Group was formed last year and carried out a consultation on a set of standards for the professional trustee industry, along with an accreditation framework. We will expect professional trustees to meet the standards when they have been published, and demonstrate they have done so through obtaining the accreditation.

Encouraging consolidation

Ultimately, our aim is to reduce the number of poorly governed DC schemes and we will use a range of approaches in order to achieve this. We will shortly begin the process of authorising master trusts and, although these schemes are generally very well run, the process of authorisation will ensure that all the master trusts in the market reach the standards we expect.

Where trustees are unwilling or unable to take action to improve standards of governance in their non-master trust DC scheme, we will work with these trustees to protect member's benefits, including encouraging them to transfer their members into better run, better value schemes, such as master trusts. The process for this has now been made easier for many schemes following the recent changes in the law on bulk transfers of pension benefits.

Annex A: Key research findings and messages

1. Scheme governance

Key findings

- 92% of trustees believed that they have sufficient time and resources to run their scheme and 90% felt that they had the necessary knowledge and understanding.
- However, trustees were less likely to have training and development plans in place or ensure that new trustees complete the toolkit or equivalent within six months of their appointment. These expectations were least likely to be met by smaller schemes - less than half of small and micro schemes had training plans in place, and just over half required new trustees to complete the toolkit or equivalent, although this is a slight improvement over the 2017 results.
- All master trusts and 90-95% of medium and large schemes confirmed that they review the suitability and performance of the default strategy at least every three years. The figures for small and micro schemes were much lower (around 60-80%) and have decreased since 2017. Very few small and micro schemes conduct any member analysis or research before designing their default strategy.
- All master trusts and the majority of large schemes have agreed service standards and track the timeliness and accuracy of core transactions as well as taking action to address any gaps in data quality. Howevern the number of master trusts reviewing their common and specific data on an annual basis has decreased since 2017. Only 33% of small and 23% of micro schemes track the timeliness and accuracy of core transactions.
- Around nine in ten schemes believed they could obtain the information required to carry out a value for members assessment, an increase of 5% from 2017. However, only 57% of small and 53% of micro schemes had carried out this assessment. The majority of trustees also felt they had a good understanding of the costs and charges deducted from members' funds, both in default arrangements and self select options, although the percentages were lower for small and micro schemes. Only 17% of small schemes carry out research and take into account what members care about when assessing value.

As with last year, the research has shown a degree of cognitive bias among some trustees – they think they are meeting the standards when the evidence points to the contrary, particularly amongst small and micro trustees. Our expectation is that new trustees receive adequate training and that their knowledge and skills are kept up-to-date by way of training and development plans.

The failure of the majority of small and micro schemes to track the timeliness and accuracy of core transactions concerns us as this can result in delays or inaccuracies that could significantly affect members' benefits. We also consider it important to conduct some form of member analysis or research before formulating a default strategy, as well as finding out what members care about when carrying out a value for members assessment. We would also like to remind trustees that carrying out an annual value for members assessment is a legal requirement, and they are required to confirm compliance with this requirement on their scheme return.

2. DC code expectations

Key findings

- Although the overall number of DC schemes meeting the expectations set out in our code has risen slightly since 2017 in some areas, it has decreased in others. Compliance amongst small and micro schemes remains lower than that of medium and large schemes and master trusts.
- The worst performing area across the board was investment governance, with an average of 23% of schemes meeting our expectations. This was largely due to only 14% of small and 19% of micro schemes meeting expectations.
- There was an increase from 2017 in the proportion of schemes meeting our expectations for managing commercial relationships – in particular, an increase of 11% for medium schemes and 10% for micro schemes.
- Schemes using a third party administrator performed better against code expectations than scheme that used an in-house administrator.
- The majority of scheme members are in a scheme which meets the expectations set out in our code, but this is due to the fact that the majority of members are in a master trust arrangement.

We are pleased that the majority of members are in a scheme which meets our expectations but note that this reflects the high volume of members in master trusts. We remain concerned about the inability of small and micro schemes to meet our expectations. Compliance is particularly low for these schemes in the areas of administration and investment governance. Both of these areas, if not managed properly, can have a detrimental effect on members' benefits.

3. 21st century trustee campaign

Key findings

- Almost half of the respondents recalled receiving the 21st century campaign emails, however, of those representing small schemes, only 27% could recall them
- Overall 75% of those receiving the emails found them to be clear and useful, with micro schemes finding them the least clear.
- Over 60% of medium and large schemes and master trusts took action as a result of receiving the emails. Small and micro schemes were less likely to take action (48% and 28% respectively).
- The main reason given by micro schemes that took no action was that it was not relevant to their scheme, closely followed by those that believed that no action was needed as they were already doing all they were required to do. This latter was also the reason given by 50% of small schemes who took no action.
- The campaign was structured into nine themes, each providing advice on action that should be taken to meet standards we expect. Large schemes and master trusts were most likely to meet all nine standards whereas only 6% of micro and 1% of small schemes met all nine.
- The most common reason for not meeting each standard was that schemes did not believe it was relevant to them.

The above results indicate that the majority of small and micro schemes are not meeting the standards we would expect and that this is mainly due to the fact that they do not believe our expectations are relevant for a scheme such as theirs.

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