

# DC Governance: a checklist

Is your scheme following best practice?



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DC governance should focus on appropriate due diligence to ensure your scheme has the best chance of delivering optimal outcomes for members. But that's not to say it's all about processes. Sound governance includes anything that involves taking practical steps to reduce the risk of DC scheme members suffering adverse outcomes.

At the heart of all good DC scheme governance lies a clear understanding of your objectives. Whether you are the sponsoring employer or a trustee, what does success look like for you? And what can you do to help ensure you achieve it?

In this paper we focus on four governance factors that we believe are instrumental in helping to deliver your DC scheme objectives:

- **Following the DC code** – Are you taking due notice of the guiding principles provided by the regulator? Does the trustee board have the necessary skills and experience to run the scheme effectively?
- **What's your investment strategy?** – Are as many members as possible going into the investment strategy that's right for them? Is your default arrangement reviewed regularly?

- **Adviser and service providers** – Are you evaluating effectively whether your advisers and service providers are helping you to meet your objectives?
- **Governance resources** – Do you have the governance time, budget and skillset to help you achieve your objectives?

## THE REGULATOR'S DC CODE

### What should you expect?

The direction of travel from the pensions regulator is clear: higher expectations for trustees and scheme managers are on the way. This is to help support members in meeting the challenges of increased flexibility and complexity of decision-making in a post-Freedom and Choice world.

The recent high levels of transfers out of DB schemes are posing further risks to members from poorly governed at-retirement solutions.

The DC code has four key messages for trustees.

**They must:**

1. Act with integrity and competence
2. Act in the interests of scheme members and beneficiaries
3. Be financially sound (professional trustees)
4. Have appropriate levels of knowledge

Value for money is a key area of focus for DC schemes, so how can you ensure this? Of course, it can mean offering low-cost solutions, but it's important to remember that low cost does not always equal good value. From our experience, engaging member communications, offering high quality service to members and providing an effective at-retirement solution are now top of the agenda for many trustees and sponsoring employers.

Forthcoming regulation of master trusts will reduce the number of such arrangements, raising governance standards and reducing risks to members as only the strongest, best-run trusts will remain.

The DC Code also suggests that default investments should be reviewed every three years. From our experience, we would take this one step further and suggest that schemes should not restrict themselves to set review periods but should instead consider reviews to react to evolving markets, regulations and member needs.

In summary, DC schemes should ensure that they have a focus on doing the right thing for members and have the appropriate level of skills and capability to perform this duty effectively.

## WHAT'S YOUR INVESTMENT STRATEGY?

**Is the 'default' default appropriate post-Freedom and Choice? Is the fund range broad enough to meet a wide range of member needs?**

With continued high numbers of members using default investments, having a default that is appropriate for the majority is crucial in improving overall member outcomes. Traditionally, focus has been on accumulation designs but post-Freedom and Choice, the 'decumulation' strategy should be a high priority. Schemes often offer two de-risking strategies, one which targets future annuity buyers, and one which targets drawdown investors. Some offer a third for those taking cash.

A 'default default' that is still popular is one that de-risks towards an asset allocation designed to smooth the path towards an annuity purchase. However, this seems at odds with member behaviour, particularly since income drawdown is expected to become the most common method of post-retirement income.

Many surveys<sup>1</sup> highlight that very few individuals know their retirement plans far in advance and our research ([Is de-risking a good idea?](#)) found that for many individuals, de-risking is not necessarily the optimal investment strategy – they may be better off remaining invested for longer.

If a scheme offers multiple solutions, therefore, some form of guided journey could be offered to help members understand the potential opportunities and risks of each choice. It's also essential that trustees understand member demographics and behaviour, and tailor solutions accordingly. This means not only having an appropriate default, but also making other options available to cater for different needs and risk appetites.

For example, schemes should offer a broad range of single asset class funds for those looking to build a portfolio tailored to their individual objectives.

The DC Code also requires trustees to consider the financial sustainability of their investments, so they should also consider environmental, social and governance factors.

1. See, for example, Pensions Policy Institute's Briefing Note Number 72. 'DC savers' needs under the new pension flexibilities', October 2014

## DISCUSSIONS WITH ADVISERS AND SERVICE PROVIDERS

### Questions you might want to ask and how you can evaluate the responses

In many cases, advisers and providers have been in place for some time, so it's important to evaluate whether they continue to help you meet your objectives.

A good provider should offer value for money, performance that meets agreed targets, engaging communications, funds that meet members' future needs and at-retirement solutions that seek to minimise 'out-of-market' cost and risk.

With the continued consolidation in the provider market, it is critical to understand what that means for your DC scheme. Will your scheme end up on a legacy administration platform? Will the service to members be disrupted? Will the provider be able to invest in technology, administration and communications?

Where a third-party administrator is in place, it's important to evaluate how flexible and adaptable their service is to meet changing member needs. Does the administrator have the financial strength to continue investment in technology, automation and at-retirement solutions? Is pension administration a core part of their business and is there a demonstrable commitment to the DC market?

Does the investment platform offer a range of funds and solutions for each part of the investment journey, as well as 'one-stop-shop' options for the whole journey 'to and through' retirement? Can the platform add funds and blends easily and cost effectively? What are the platform costs for accessing funds? Have these been benchmarked against the market?

Where an adviser solution is in place, questions should also focus on conflicts of interest. Ask how the charging structure works and what benefits these bring to you as trustees or sponsoring employers. Is the range of funds sufficiently broad to account for the wide range in different retirement objectives among members?

Ultimately, if advisers and service providers are not performing as expected, we believe trustees or sponsoring employers should push them to improve the situation as quickly as possible or replace them.

## CONSIDERING GOVERNANCE RESOURCES

### Do you have the time, budget and skillset to achieve your objectives? Is delegating the governance a better solution?

As DC becomes more sophisticated, with more complex decisions at retirement, new asset classes and strategies to consider and tougher regulations to comply with, the burden of delivering better member outcomes increases.

This can mean that immediate challenges of day-to-day governance and administration take centre stage, with other initiatives, especially member engagement, being compromised. To counter this, one option is to consider a fiduciary solution, or master trust.

A master trust allows employers to fully outsource the governance, investment and administration of their DC scheme. Not only are the investments designed and managed by experts, but the whole delivery of retirement savings is entrusted to those whose expertise and resources are focused on ensuring the best experience for members and employers. Master trusts also have the benefit of strong, independent governance from designated professional trustees.

Taken together, this can free up resources for other key factors that are crucial in helping to achieve better member outcomes and a better return on investment.

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