

# DC and DB research response

September 2017

The Pensions  
Regulator

Our key focus is to ensure that all pension schemes are well run, provide good value and are well funded, so their 22 million members get the benefits they expect.

To understand the extent to which schemes meet the expectations we set out in our codes and guidance and what barriers trustees are facing in running their schemes, we undertook two surveys<sup>1</sup> of DB and DC schemes in spring 2017. Both surveys, which build on previous research<sup>2</sup>, covered common questions on scheme governance as well as legal and code requirements specific to each type of scheme.

The survey results show some improvements in DC governance and administration and increased levels of understanding and compliance with our DB code principles. The majority of members are in relatively well-run schemes but this is a feature of larger schemes being better managed. Results for individual small and medium schemes are disappointing:

- ▶ They tend to display poorer governance standards, for instance they place less focus on training arrangements, regular board assessments, effective internal controls and oversight of third parties.
- ▶ Many small and medium DC schemes, and a significant number of DC schemes used for AE, are not meeting standards around administration (eg ensuring prompt and accurate transactions) , investments (setting appropriate investment strategy for the default fund) and value for members (assessing quality of services provided to members).
- ▶ Significant issues also remain among DB schemes, in particular around integrated risk management and fair treatment of the scheme.

We highlight some key findings from the survey and reiterate our expectations across these particular themes in Annex A. In the section below, we set out what we'll do over the next year to address these issues.

As our research shows, while some trustees are doing a good job, many trustee boards are failing to meet the basic standards of good governance and administration and to manage scheme funding effectively. We are encouraged by the fact that larger schemes, and in particular master trusts, are on the whole better run but are concerned about the long tail of small DB and DC schemes which our research suggests are sub-standard.

1  
[www.tpr.gov.uk/research](http://www.tpr.gov.uk/research)

2  
[www.tpr.gov.uk/research](http://www.tpr.gov.uk/research)

As we explained in our 21st century trustee work<sup>3</sup> and in our recent Corporate Plan,<sup>4</sup> we have prioritised addressing poor standards of stewardship and risks around sub-scale schemes and poor data integrity and security. We intend to take a range of actions focused on being clearer about what we expect schemes to do, taking greater enforcement action where they are not complying and encouraging sub-standard schemes to consolidate where appropriate.

Our TPR Future programme,<sup>5</sup> which has identified five central opportunities for change to ensure that our regulatory approaches are clearer, quicker and tougher, will put us in the best possible position to meet these challenges. In particular, we are looking to improve our regulatory oversight and broaden the range of regulatory interventions to drive behavioural change.

## Clarifying our expectations

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. We think that being clearer, more succinct and directive will help the trustees of small schemes to focus on the activities that can make a difference for their members.

As part of our 21st century trustee work, we'll shortly launch a programme of communications to trustees, advisers and employers covering the basics of good governance, ie the key factors that support effective decision-making such as clear roles and responsibilities, strategic planning, board competence, effective trustee meetings, effective oversight of third parties, sound risk management and value for members. To help trustees assess and improve their schemes, we'll focus on key actions to take and provide examples of good, poor and best practice behaviours and create some additional tools (eg board assessment template or questions to service provider checklist).

We want to make sure our expectations are clear and support quicker enforcement action where our standards are not being met. As part of this, we're reviewing our guidance to make sure we're engaging with those we regulate effectively. This will include streamlining our existing stock of guidance to ensure it continues to reflect our regulatory priorities and can be easily accessed on our website. We have also started work to refresh our website to improve the audience experience.

3  
[www.tpr.gov.uk/21c-trustee](http://www.tpr.gov.uk/21c-trustee)

4  
[www.tpr.gov.uk/plan](http://www.tpr.gov.uk/plan)

5  
[www.tpr.gov.uk/future](http://www.tpr.gov.uk/future)

The DC chair's statement is an important tool for boards to focus on key areas of governance and administration and provides members with key information, for example on costs and charges. However, we have come across statements of varying quality. We will produce a guide on what a good chair's statement looks like to help the trustees of DC schemes meet the standard set out in legislation.

Given the increased prevalence and importance of professional trustees, our focus is also to make sure they meet the higher standards we expect. We've recently clarified our professional trustee description as part of our published monetary penalties framework.<sup>6</sup> At the same time, following a recommendation by TPR, the Professional Trustee Standards Working Group<sup>7</sup> has come together with the goal of establishing a set of fit and proper standards to be met by professional trustees. The group will be consulting later this year with members of the profession before the protocols are adopted. We will encourage professional trustees to adhere to the protocols.

## Taking action

Greater clarity will also mean being clear on the consequences of not meeting the standards we expect, and this includes taking targeted enforcement action where appropriate.

We have already increased our focus on ensuring compliance with basic duties (such as completing the scheme return and DC chair's statement<sup>8</sup>), which can be an indicator of broader governance issues.

We'll take greater enforcement action against wider governance failings, focusing on schemes with poor trustee knowledge and understanding, internal controls (including conflicts management), record-keeping and value for members (VfM).

Trustees will be asked to report on their record-keeping standards in the scheme return so we can intervene and enforce if necessary if they are failing in their duties and not taking appropriate steps to improve their records.

As part of TPR Future work, we are looking to expand our range of regulatory approaches. In particular, we intend to undertake more thematic reviews, for instance around maintaining contributions and VfM, to assess emerging risks across a number of schemes or employers.

<sup>6</sup>  
See 'Closed with response' at [www.tpr.gov.uk/consultations](http://www.tpr.gov.uk/consultations)

<sup>7</sup>  
<http://bit.ly/2vwubGr>

<sup>8</sup>  
[www.tpr.gov.uk/chairs-enforcement](http://www.tpr.gov.uk/chairs-enforcement)

To raise governance standards in DB schemes, we're taking a tougher approach if schemes fail to submit their valuations on time. This remains unacceptably commonplace, with approximately 10% of DB schemes completing their scheme valuation later than the statutory deadline in 2016. Our annual funding statement notes that we are more likely to take enforcement action in relation to the breach of law in this area, when delays could have been predicted, or where trustees do not engage with us regarding the breach.

We'll also be undertaking more proactive casework and developing our approach and interactions with smaller schemes, focusing on funding and governance issues. We'll consider opening a DB scheme investigation where unfair treatment is apparent, particularly if recovery plan end dates are being extended unnecessarily or where the employer covenant is constrained and total payments to shareholders are being prioritised. This is a key area of focus for us in relation to DB funding and we'll take steps to ensure an appropriate balance is struck between the interests of the scheme and shareholders by the employer.

We will continue to publish information about our cases and the powers we've used in our compliance and enforcement bulletins and regulatory intervention<sup>9</sup> to inform the industry of our activities and increase trustees' understanding of their duties.

## Encouraging consolidation

We believe that, over the long term, there is a good case for consolidation where standards are not being met.

We are working with government partners and providers of legacy schemes to develop a consistent approach to winding up DC orphan schemes (where there is no longer a trustee or employer in place) to reduce the overall number of schemes at risk of poor governance.

We'll also be encouraging DC schemes that are unable to provide VfM to consolidate into better run, better value products.

We continue to support the Department for Work and Pensions in exploring options for stressed schemes as outlined in its current green paper on the security and sustainability of DB schemes.

9  
[www.tpr.gov.uk/  
enforcement](http://www.tpr.gov.uk/enforcement)

# Annex

## Key research findings and messages

### 1. Scheme governance

#### Key findings

- ▶ The majority of DB and DC trustees said they have sufficient time and resources to run their schemes effectively and most DC trustees thought they possessed or had access to the necessary knowledge and skills.
- ▶ However, more than four in ten DC and DB schemes failed to regularly evaluate the performance and effectiveness of their boards and many small DC schemes did not know what expertise or specialist knowledge trustees on the board have and had limited trustee training arrangements in place.
- ▶ A significant proportion of micro and small DC schemes do not have a risk register or never review the scheme's exposure to new and existing risks (or do not know whether they do). Only a quarter of AE and legacy DC schemes said they managed and monitored conflicts of interests.
- ▶ By contrast, 83% of DB schemes said they had documented processes to do so. However, many DB schemes were found to have poor integrated risk management practices (see below).
- ▶ Although the majority of DC non-master trust schemes use external advisers and providers, few have reviewed service providers' internal controls and over a third do not have procedures in place to assess and address the effectiveness and performance of third parties.

The research has shown that there is a high level of cognitive bias among some trustees – they think they are meeting the standards when the evidence points to the contrary. We expect trustees to put in place training arrangements and regularly evaluate their skills and knowledge gaps and their performance, including decision-making, so they can take action to improve. Sound risk management should also be a key priority for trustees as poorly understood and managed risks, including conflicts of interest, could have a catastrophic impact on member outcomes. Trustees retain accountability for operations and activities where they have delegated responsibility to others and should therefore maintain sufficient oversight of the work undertaken on their behalf (processes and performance against agreed standards).

## 2. DC schemes

The purpose of the DC survey was to measure compliance with legal requirements and the expectations we set in the new DC code of practice and supporting 'how to' guides we published last year.<sup>10</sup>

### Administration

#### Key findings

- ▶ Very few schemes comply with the requirement to process core scheme transactions promptly and accurately. While the survey shows encouraging improvements, with a majority of schemes reviewing their common and conditional data annually, half of legacy DC and a quarter of AE DC schemes do not have documented standards for transaction speed. Of the schemes that set standards, many do not track performance against these standards.
- ▶ Schemes using a third-party administrator (TPA) typically have the most robust administration in place – for instance schemes with TPAs were more likely to have business continuity plans whereas most micro schemes administered in-house did not.

Failure to set suitable service standards and track the administrator's performance against them can result in delays or inaccuracies that significantly affect member benefits, for example by exposing members to 'out of the market' risk. Generally, this failing suggests trustees are not prioritising administration and putting the right controls and processes in place as they should, despite most schemes saying they discuss administration issues at trustee meetings. We also expect in-house administration teams to have sufficiently robust processes in place proportionate to the size of the scheme and complexity of the administration operation.

### Investment

#### Key findings

- ▶ While the majority of schemes reviewed the suitability of the default investment strategy at least every three years, in only 43% of schemes did member analysis and research contribute to its design.
- ▶ A third of legacy DC and micro schemes said they did not know what investments the scheme offered.

<sup>10</sup>  
[www.tpr.gov.uk/code13](http://www.tpr.gov.uk/code13)  
 and [www.tpr.gov.uk/dc-standards](http://www.tpr.gov.uk/dc-standards)

One of the trustees' most important tasks is to set an appropriate investment strategy for the default fund. Gathering information on the characteristics of the membership to understand their needs and how these might change is a vital aspect of good investment governance.

Even if investment services are bundled with a provider, we expect trustees to understand and be satisfied with the investment arrangements the provider has in place.

## Value for members

### Key findings

- ▶ While over three quarters of DC members were found to be in schemes meeting the legal requirement to assess the extent to which charges and transactions costs provide good VfM, two thirds of schemes do not comply.
- ▶ Only half of micro and small schemes had documented processes in place to assess at least annually the value offered by costs and charges.
- ▶ Although a high proportion of schemes said they were confident of obtaining the relevant information for VfM assessments and had a good understanding of member costs and charges, less than half of schemes said they researched and took account of the characteristics, preferences and needs of their members.
- ▶ Among the small minority (7%) of schemes that were not confident of obtaining VfM information, one of the key barriers was the ability or willingness of external providers to supply a breakdown of relevant costs, in particular transaction costs.

This suggests a significant proportion of schemes do not understand what is required to undertake a meaningful assessment of VfM. In our DC code and supporting guide on value for members, we stressed the fact that compliance with the charge controls will not necessarily provide good value for members. Trustees should consider whether the combination of costs and what is provided for these costs is appropriate for the scheme membership. We therefore expect trustees to assess the scope and quality of scheme services offered to members.



We recognise the challenges that trustees face in obtaining information about transaction costs, and the FCA is consulting on rules which compel providers to disclose this information to trustees. We expect trustees to engage early with external providers and establish the lead-in time required to provide information about transaction costs. We also expect trustees to be tenacious and record any problems and the steps they are taking to obtain that information in the future.

### 3. DB schemes

The main aim of the DB survey was to provide a performance measurement against eight of the nine principles within the DB funding code of practice,<sup>11</sup> among trustee boards and employers of DB and hybrid schemes.

#### Integrated risk management

Our DB code states that trustees should implement an approach which integrates the management of employer covenant, investment and funding risks, identifying, assessing, monitoring and addressing those risks effectively. We asked both trustees and employers whether they took five actions in relation to managing risks within their scheme and to rate their scheme's performance against this risk management principle.

##### Managing risks: the five actions

1. Investment strategy and funding plans based on an updated view of the risk that can be backed by employer covenant
2. Risk taking in the investment strategy and funding plans are set following agreement of a risk appetite discussed with the employer
3. Funding and investment performance are monitored to defined tolerances
4. Clear plans for action when tolerances are breached or on some other trigger
5. Trustees able to evidence how they have taken an integrated approach to risk management

11  
[www.tpr.gov.uk/code3](http://www.tpr.gov.uk/code3)

### Key findings

Most trustees and employers rated their performance positively, with large scheme trustees more likely than others to rate their scheme as 'very good' against the principle. However, we are concerned that almost one third of trustees who rated their board's performance to be "very good" were not undertaking all five actions.

The most common weakness identified was a failure to have a clear plan for action when tolerances were breached.

We have made our expectations clear, in our 2017 DB scheme Annual Funding Statement<sup>12</sup> and integrated risk management (IRM) guidance<sup>13</sup> that all trustees need to monitor risks and take action when required, irrespective of the scheme's funding position.

As noted in the DB funding code of practice, Trustees should have a view on the range of likely adverse outcomes that could apply and have an adequate and flexible strategy and governance structure to address these outcomes in the event downside risks materialise. This may be as valuable to the employer as it is for the scheme because potential volatility can be damaging for both.

### Fair treatment of schemes

Our DB code states that trustees should ensure the scheme is treated fairly among competing demands on the employer in a manner consistent with its equivalent creditor status. We asked trustees if they had taken any of the four steps outlined in the code to secure fair treatment for their scheme. We also asked trustees and employers to rate their scheme's performance against this principle.

#### Fair treatment: the four steps

1. Establishing whether other creditors to the employer are contributing fairly
2. If the employer is paying dividend, checking that the return to its shareholders is appropriate
3. Checking whether the employer is maintaining or increasing dividends
4. Establishing if and how the employer intends to cover risk, if needed

12  
[www.tpr.gov.uk/  
 statement2017](http://www.tpr.gov.uk/statement2017)

13  
[www.tpr.gov.uk/irm](http://www.tpr.gov.uk/irm)

### Key findings

- ▶ The majority of trustees and employers across all scheme sizes rated their scheme performance positively. However, there is a significant unrecognised weakness among trustee boards, with around one quarter of trustees asserting very good board performance but not knowing if they carried out any of the four listed steps.

We recognise there are competing demands on DB employers. However, we expect trustees to take necessary action to secure fair treatment of the scheme.

## 4. Trustee understanding of key duties and engaging with TPR

### Key findings

- ▶ Both surveys show good levels of awareness and knowledge of the relevant DC and DB codes (although this reduces with scheme size) and a high proportion of schemes are engaging with our website and its content.
- ▶ However, scheme return completion rates and survey response rates are decreasing.

We are concerned that this poor level of engagement by some trustees could be symptomatic of a lack of engagement with their scheme overall. We are likely to use such indicators of disengagement when we decide whether to engage with individual schemes.

The law requires a scheme return to be completed and we expect trustees to comply with this basic duty. Scheme returns are a key tool for us – the information collected is used in a variety of ways, for example to calculate the levy, monitor regulatory requirements such as the DC chair's statement, assess risks in the landscape and support the Pensions Tracing Service.

We also expect trustees to make the best effort to respond to our research surveys. Like the scheme return, they are an important means of understanding trends in the landscape and the issues faced by trustees and assessing the effectiveness of our approaches.

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