Mind the DC governance gap

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A notable trend in the pensions landscape right now is the number of single employer trust arrangements that are setting up dedicated defined contribution (DC) committees.

1. Introduction

We explore the factors driving this governance shift, highlight other general points to consider before concluding it's the right approach, and identify some key requirements for a new committee.

2. The drivers for setting up a DC Committee

A range of factors have led many single employer trust-based schemes to consider setting up a DC committee.

- Time pressures - governance responsibility for DC has typically tended to fall between the trustee board and (where it exists) the investment committee, with perhaps the employer also playing a role in communications and/ or administration. Unfortunately, the numerous challenges faced by defined benefit (DB) schemes in recent times has often resulted in consideration of DC benefits being relegated lower down the agenda, and sometimes dropping off altogether. Most schemes are now realising that a lack of dedicated and coordinated focus is no longer tenable.
- Pot size – the growing maturity of many DC arrangements, impact of auto-enrolment as well as the ongoing bull run in stock markets have meant that average pot sizes have increased dramatically. They are no longer an incidental component of many members' retirement savings, and indeed form the bulk of retirement provision for those with little or no legacy DB. This has helped focus trustee minds on the need to ensure these arrangements are governed rigorously with maximum value obtained.
- Regulatory scrutiny – the Pensions Regulator has significantly increased the level of focus applied to DC governance, and this looks set to continue. For example, the Regulator now publishes a list of schemes each quarter where a chair's statement was not produced in time. The names of schemes where trustees received fines in respect of statements that were not legally compliant is also published. Few trustees, or their sponsors, have any desire to undergo this level of public censure and reputational impact, so more trustees are questioning whether their current governance model is adequate.
- Freedom and choice – the new freedoms introduced in recent years mean the range and complexity of options available to members as they approach retirement has increased significantly. Although DC schemes must offer a default investment option, the new regime means that a 'one size fits all' solution is not appropriate, and for many members alternative routes may suit better. For example, a member with a material legacy DB, may expect to make different choices at retirement and have a very different risk profile to a member for whom the bulk of their retirement savings is made up of DC benefits. As a result, there must be a much greater emphasis on member engagement and communications, and those processes need to start early and be repeated regularly.
- A further development is the increased attention being paid to value-for-members. Trustees now need to make information available in the chair's statement and online that illustrate the impact of charges on members' pots at retirement. Again, this is an area of increased regulatory focus, and indeed the most recent annual DC survey published by the Pensions Regulator highlighted that many small and medium schemes are not doing everything the Regulator believes is essential to assess value for members. Once again, whilst the greater transparency and consideration of value is to be welcomed, it has added to the pressures on trustees to ensure these activities are undertaken in a robust and thorough way.

3. Don't jump to conclusions too quickly

For many schemes, the case to set up a dedicated DC committee is increasingly compelling. However, before concluding that this is the case, it's worth pausing for thought and considering whether it is appropriate to continue to offer DC benefits through a sponsor's single employer trust arrangement. For example, it's possible that the sponsoring employer runs another arrangement such as a GPP that might provide a better vehicle for the provision of benefits. Joining forces might bring cost and governance synergies. Alternatively, a master trust (a multi-employer scheme where each employer has its own section) might be appropriate; the economies of scale and governance budget available may result in greater value for members. It is therefore essential to consider the pros and cons of the different arrangements that can be used to deliver DC benefits before finalising a decision.

It's also important to determine whether members of the trustee board will be willing to sit on the committee, and particularly whether they have the time to dedicate and/ or have a suitable skill set. DC has sometimes been seen as the 'poor relation' and does not always attract the same level of interest as other governance forums and management of DB.

4. Setting up your DC committee

If you do decide that a DC committee is the right course of action, here are some key points to consider.

- Start with a challenging and well-defined set of objectives and a strategy for achieving those. But do not fall into the trap of being more ambitious than you can realistically deliver. For example, the greater the number of lifestyle options and the wider the fund range, the greater the amount of 'governance budget' needed, both in terms of time and money.
- Invest the time up front to put a sound governance 'infrastructure' in place. In addition to a statement of objectives and strategy, there should be terms of reference, a business calendar, risk register, training plan and so on. This will help ensure better prioritisation of activity and use of resources, as well as a clear understanding by the trustee board of the extent of delegations to the committee.
- Understand members' views and requirements, as this can be a valuable input to determining an appropriate strategy as well as the order for tackling key issues. For instance, many trustees find it helpful to gather objective member data on topics such as ESG as well as demand for alternative fund choices.
- Consider whether your existing advisers are best placed to support the new committee. Most employee benefit firms have established dedicated DC practices in recent years, with strong experience in supporting DC investment strategy reviews as well as member engagement and communications. So before automatically procuring support from your existing investment consultant and/ or communications provider, a selection exercise may be in order.

If you already have a DC Committee in place, consider whether it is performing as intended, and if a review of its effectiveness should be undertaken.

5. Conclusion

There is no doubt that an increased focus on the management and delivery of DC arrangements is here to stay. For a considerable number of schemes, a single employer trust arrangement will continue to be a suitable vehicle through which to provide these benefits – albeit many now need to review the efficacy of their approach. This includes considering setting up a DC Committee to bring sufficient focus to governing the DC benefits.