

What is the Ideal DC Scheme?

Viewpoint – June 2014

There has been a huge amount written about Defined Ambition and Collective DC schemes following the Queen's Speech on 4 June 2014. Many would have you believe that this is the answer to all our problems. I am still to be convinced and believe that good quality DC schemes can deliver great benefits to members. Clearly they don't do that in all cases yet, so what is required to create the ideal DC scheme

1 Governance

It doesn't matter what type of DC scheme we are talking about, someone needs to be responsible and take the management of the scheme seriously. The people running the scheme, the 'Governors', need to make sure that the scheme is running well. That covers the administration, the investments and how the scheme is communicated.

Having DC experts supporting the Governors is critical. Best practice is developing rapidly as experience of DC governance accumulates. For master trusts and contract based schemes, the employer may think that it can take a step back. Whilst it is true that someone else has the direct governance responsibility for the members, the employer should be engaged to make sure that the scheme is delivering value for money. The establishment of internal governance committees by employers, including employee representation, is one way to keep a focus on value for money.

2 Scale

The Pensions Regulator has disclosed evidence that larger schemes tend to have better processes and controls in place. So, big schemes are best. But why? One reason is that governance is more likely to be affordable, because whilst the costs increase, the cost per member of running a DC scheme reduces for larger schemes.

As an example, let's consider the new annual compliance review for master trusts. If it is going to cost £50k per annum, then a 100,000 life scheme costs 50p per member per year. Even if those costs reduce to £30k for a 2,000 life scheme, the cost is up to £15 per member per year.

3 Contributions

Higher contributions deliver better outcomes! Not rocket science I know, but the question is what structure works best. In my experience, one that incentivises members to engage with the scheme and take ownership can lead to higher contribution rates.

A matching structure, where members receive higher contributions from the employer if they pay in more, is a great way to encourage members to save into a pension scheme.

An example of the benefit of the matching structure - e.g. £1 of a member's money becomes £3.25 in the pension scheme (based on a 2 for 1 match and the member being a basic rate tax payer) - can really focus members on the value to them of the scheme.

4 Investments

Some will say that the scheme should be invested 100% in passive funds to minimise costs to members. Others will contradict. I think it will depend on the governance appetite, capabilities and budget of the 'Governors'.

If they have the ability to implement white labelled funds and to constantly monitor and manage the underlying asset managers, then active management and DGFs can provide better, or less volatile, returns. Where governance capabilities are limited, then a small range of passive funds, or maybe a delegated mandate might be best for you.

5 Communications

Clear, action focused communication material is vital for an ideal DC scheme. Members need to be regularly made aware of their situation. Examples of the sort of information that members should receive from their scheme could include:

- How much are they paying into the scheme;
- The expected benefit from the scheme (whether in terms of a cash amount or a pension);
- How can they work out what their retirement needs might be;
- What can they do to balance the expected level of benefits with their expected needs.

You will not engage with all members, so an appropriate default position in terms of the contributions and investments needs to be set. However, once members are in the scheme, as the size of their fund increases, there is evidence from Australia that the level of engagement increases.

In conclusion: what are the attributes of an ideal DC scheme.....?

To me that implies a well governed, large DC scheme, with good contribution rates and investment options, where members receive communications that help them engage and take ownership of their future. Not much to ask!

But these schemes already exist, and more importantly, they exist as stand-alone trusts, as master trusts and as contract based schemes. The vehicle will be down to employer's preference, but all can deliver.

Having a clear strategy and objectives for the pension scheme, and then executing is what matters.