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# The legal and regulatory basis of DC pension arrangements

or: trust v contract-based

**Sue Tye**

Of Counsel

9 September 2015

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# What we will cover

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- Some background
- Putting it into context – a timeline
- Where are we now?
- Independent governance committees
- What about master trusts?
- Dispute/loss/compensation — a member perspective

# Legal Framework | 1

## **Occupational pension schemes** (trust-based schemes)

- set up directly by the employer for the benefit of its employees
- established under irrevocable trust (former Revenue requirement for tax approval)
- administered by individual trustees or a corporate trustee
- governed by trust deed and rules

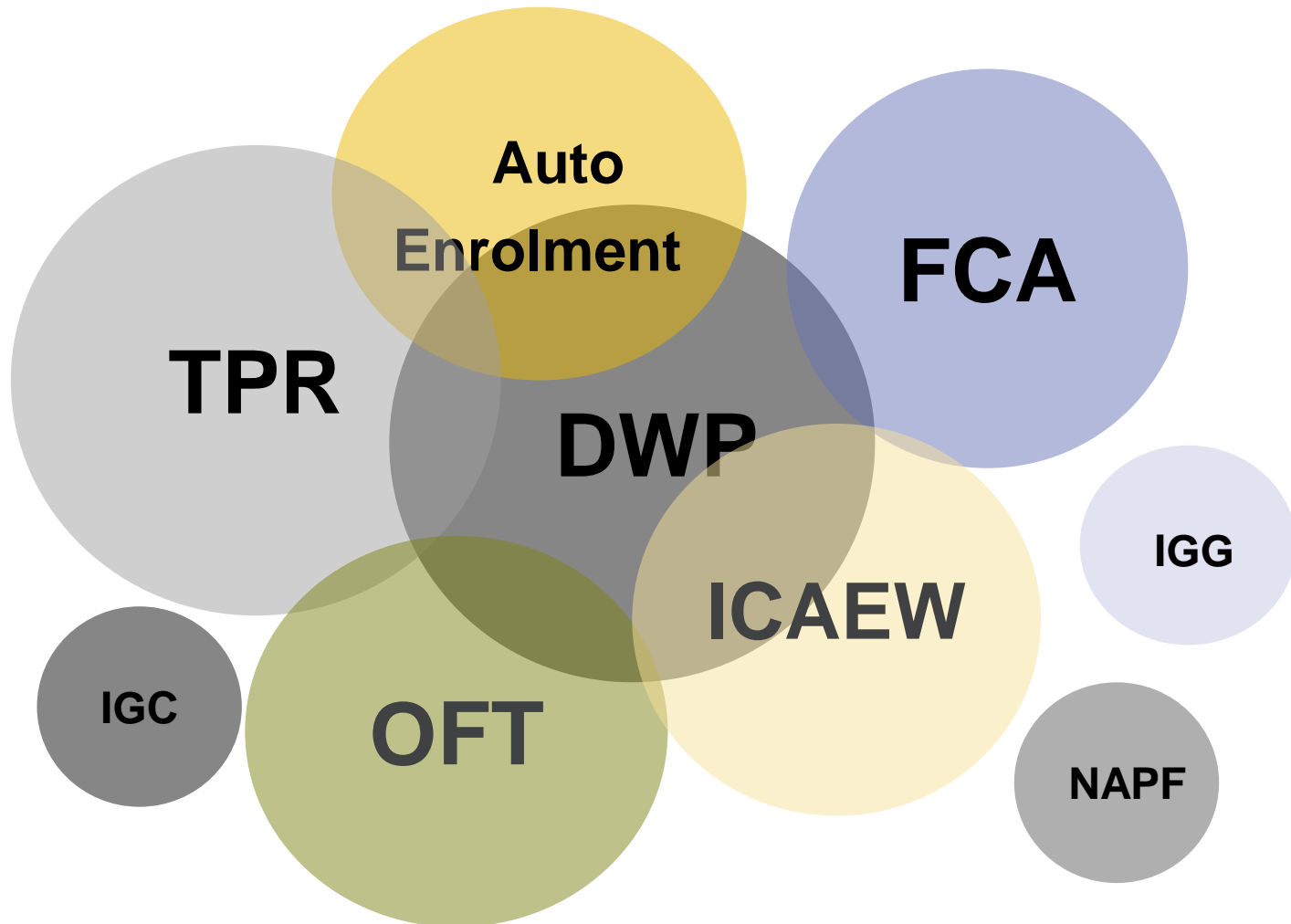
## **Workplace personal pension schemes** (contract-based schemes)

- contract between each individual member and pension provider, typically an insurance company
- badged as an employer's scheme
- employer may have contractual arrangement with provider governing service provision
- provider responsible for administering the scheme
- employer limited role/responsibilities

# Legal Framework | 2

	Trust schemes	Contract schemes
Nature of duties owed to members (over and above AE requirements)	Trustees owe fiduciary duties to members; act in best financial interests (and in accordance with rules)	No specific duty owed by employers (N.B. exemption for stakeholder plans too) Limited duties of providers under financial services laws
Investment choices	Limited exoneration/indemnity protection for investment duties Responsible for range of investment/performance monitoring/charges/comms Responsible for member choice?	Member's choice Accurate, comprehensive communications FCA compliant
Advice regime	Trustees and employers not usually FCA authorised	FCA authorised investment adviser for employer and usually made available for employees (may be at member's cost)

## One view of the legal and regulatory framework...



# DC Regulation

**Different regulatory bodies for trust-based and contract-based DC schemes:**

**TRUST-BASED =  
PENSIONS  
REGULATOR**

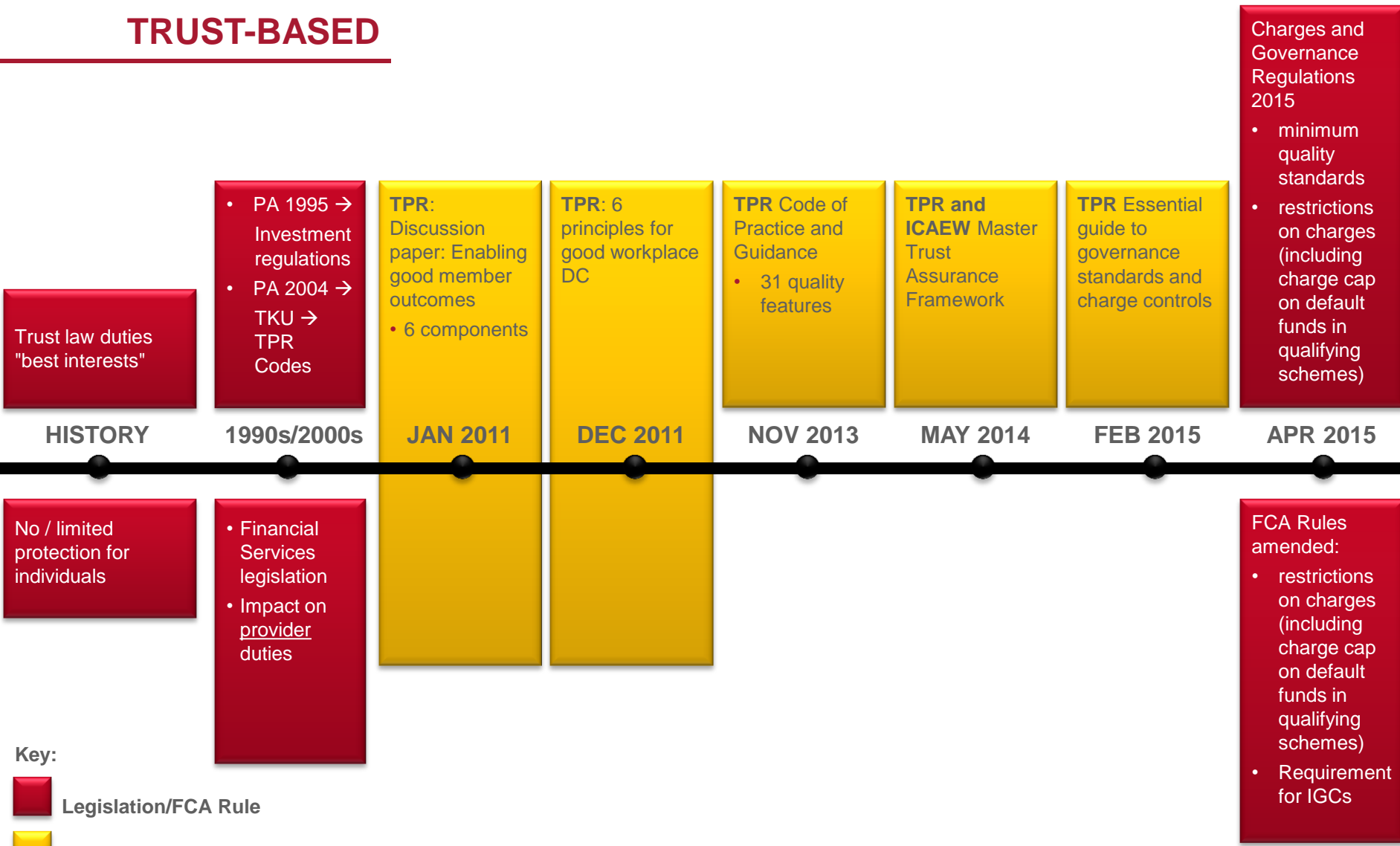
**CONTRACT-  
BASED = FCA**

- Separate regulatory regimes
- Regulator's focus historically trust-based schemes
- Under-regulation of contract-based?
- But convergence in some areas emerging....
- How does it all work?

# The legal and regulatory framework

- a timeline.....

# TRUST-BASED



Key:



Legislation/FCA Rule



Guidance

# CONTRACT-BASED



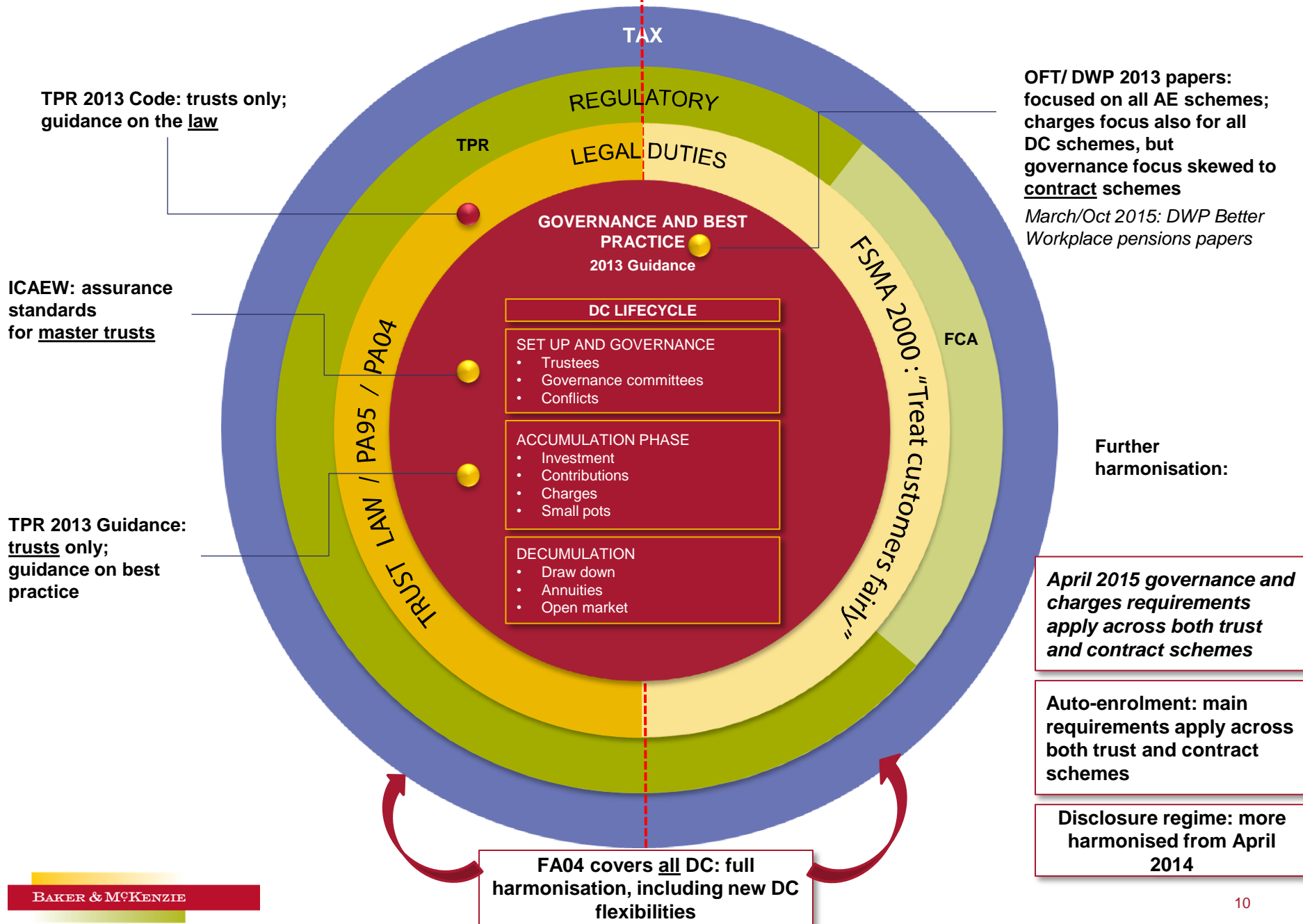
# The legal and regulatory framework

- where are we now.....

....further regulation and some  
harmonisation

## TRUST-BASED

## CONTRACT-BASED



# What is good governance?

- Governance = how trustees/managers discharge their legal duty of investing assets and paying benefits
- Good governance: a fluid concept
  - from not causing loss to value for money
  - more than bare minimum statutory/regulatory/fiduciary compliance
  - best practice
- Why important\*:
  - 3 m actives in contract-based
  - 2.6 m actives in “pure” DC trust-based
- DWP estimate 8-9 m people defaulted into pension by 2018

\*TPR DC trust: scheme return data 2014-15, as at January 2015

# Regulation and governance of trust-based schemes

- Pensions Regulator's responsibilities for DC trust-based schemes are based around:
  - promoting good scheme administration
  - employer requirements for payment of contributions
  - ensuring compliance with employer auto-enrolment duties
  - appropriate retirement outcomes
- Main regulatory focus: benefits are protected and investment funds offered appropriate to the membership

# The trust-based regulatory framework

- Principles and features for good quality pension schemes (January 2013 )
  - The 31 quality features
- Regulating work-based defined contribution pension schemes (January 2013 )
  - The 6 principles and outcomes
- Regulatory guidance for defined contribution schemes (November 2013)
- Code of Practice 13: Governance and administration of occupational defined contribution trust-based pension schemes (November 2013)

# The Regulator's 6 principles and outcomes of good DC governance

## Principles:

- Essential characteristics: durable, fair, deliver good member outcomes
- Comprehensive governance: with clear and transparent accountabilities and responsibilities
- People: duties understood and individuals fit and proper to undertake them
- Administration: well-administered, timely, accurate and comprehensive processes and records
- Member communications: designed and delivered to enable informed decisions to be taken
- Effective governance and monitoring

## Outcomes:

- Appropriate contribution decisions
- Appropriate investment decisions
- Efficient and effective administration
- Protection of assets
- Value for money
- Appropriate decumulation decisions



# TPR's DC Code and Guidance – key points

- **Applies to *all* trust-based DC schemes:** AVCs and underpins too
- **Aim:** to inspire good practice and trustee assessment of plan performance
- **Not a one-stop shop:** other Codes are still relevant: breach of law; TKU; internal controls; late payment of contributions; MNT/Ds; dispute resolution
- **How should trustees approach the Code? TPR:** “systematically”
- **Interaction between the Code and Guidance:** law v best practice
- **Status of the Code and enforcement** – not a legal requirement; no penalty; can show alternative way to comply
- **Compliance formalities?** voluntary “comply or explain” statement

# TPR's approach to DC trust-based governance

- Compliance and enforcement policy and strategy for regulating DC plans
- Drive for DC plans to meet the 6 principles and 31 quality features
- Governance statement
  - Set out extent to which plan meets the 31 quality features
  - Make available to members and employers
- TPR to monitor take-up, effectiveness and quality of governance statements
- 5 key areas
  - Know your scheme
  - Risk management
  - Investment
  - Governance of conflicts of interest and advisers/service providers
  - Administration



# Regulation and governance of contract-based schemes

- Regulated principally by the Financial Conduct Authority (FCA)
  - contract-based schemes are “regulated investments”
- FCA regulates conduct and prudential risks of providers of contract-based schemes under Financial Services and Markets Act 2000 (FSMA) and the FCA’s Principles for Business
- No trustees / fiduciary duties but providers are subject to FCA/FSMA obligations:
  - know the customer
  - treat customers fairly
  - design products to satisfy policy holders’ reasonable expectations
- No advice provider to member: member decides with / without IFA advice

# Pensions Regulator and contract-based schemes

- Responsibility for work based personal pension schemes where direct payment arrangements exist in respect of one or more members (and stakeholders)
- Pensions Regulator is also concerned with contract based-schemes and aims to:
  - work closely with employers to provide a good quality scheme
  - work with scheme providers to ensure good governance and suitable products
  - work with the FCA to streamline and ensure consistency in regulation, quality standards and member protection

# Key regulatory/governance changes from 6 April 2015 - trust-based schemes

- New minimum quality standards and charge capping requirements under Charges and Governance Regulations 2015
- Quality standards: focus on members' interests and good value
  - core financial processes: to be processed promptly and accurately (e.g. contribution investment, transfers of assets, member payments, fund switches)
  - good value: calculate and assess if charges are good value (including member borne transaction costs) at least annually
  - default investment fund strategy/performance: review at least every 3 years (or on significant change in member profile)
  - service providers: no constraints in choice of admin, fund management, advisory services – need to be good value for money
  - chairman: to be appointed and produce annual governance statement
- Charges:
  - auto-enrolment default funds only
  - single annual charge of 0.75% of funds under management (or combination of flat fee or % contribution charge plus annual funds under management charge)
  - no active member discounts from April 2016

# Key regulatory/governance changes from 6 April 2015 - contract-based schemes

- Changes to the FCA rule book to implement same charge cap on default funds
  - Personal Pension Schemes (Restrictions on charges) Instrument 2015
- Also ban on:
  - paying/receiving member-borne consultancy charges (April 2015)
  - member-borne commission charges not instigated by member (April 2016)
  - active member discount (April 2016)
- Introduction of a requirement for Independent Governance Committees
  - Personal Pension Schemes (Independent Governance Committees) Instrument 2015

# Independent Governance Committees

- FCA requires all regulated firms operating workplace pension schemes to set up and maintain an independent governance committee (IGC) from 6 April 2015
- To enhance the governance of workplace personal pension schemes
- Main duties of an IGC are to:
  - act independently and in the interest of members
  - assess the schemes' value for money
  - provide a Chairman's annual report
- Cannot make binding directions to a provider but can identify issues and escalate concerns to members, employers and FCA
- Required to have at least 5 members, including an independent chair; max 5 year term (10 years consecutive); minority provider employee members
- FCA is unable to regulate IGCs directly: duties and powers of IGC to be set out in "terms of reference" which the IGC prepares
- Annual report: provider to make publicly available
- Primary focus: default fund strategy and legacy scheme charges

## Still a role for employer governance committees?

# What about master trusts?

- “occupational trust-based pension scheme...promoted to provide benefits to employers which are not connected...where each employer group is not included in a separate section with its own trustees”
- TPR and Institute of Chartered Accountants in England and Wales (ICAEW) independent assurance framework for master-trust providers - Assurance Supplement (1 May 2014)
- Key elements:
  - trustee report on description, design and operational effectiveness of controls
  - independent assessment by chartered accountant against Assurance Supplement aligned with TPR quality features and principles
- Voluntary but TPR encourages use to demonstrate accountability and governance standards
- Annual trustee reporting expected
- Special provisions for master-trusts in DWP’s minimum governance requirements

## And finally: dispute/loss/compensation — member perspective

	Forum	Loss	Compensation
<b>Trust</b>	IDRP TPAS Pensions Ombudsman (High Court)	<ul style="list-style-type: none"> <li>• Maladministration</li> <li>• Fact/law</li> <li>• Investment</li> <li>• Provider failure</li> </ul>	<ul style="list-style-type: none"> <li>• Fund?</li> <li>• Trustees? } via Trustees</li> <li>• Provider</li> <li>• Adviser</li> <li>• Employer?</li> </ul>
<b>Contract</b>	Internal procedure TPAS Pensions Ombudsman Financial Services Ombudsman (High Court)	<ul style="list-style-type: none"> <li>• Maladministration</li> <li>• Fact/law</li> <li>• Investment</li> <li>• Provider failure</li> </ul>	<ul style="list-style-type: none"> <li>• Employer?</li> <li>• Provider</li> <li>• Adviser</li> <li>• FSCS</li> </ul>

Any Questions?







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