Burges Salmon Pensions Law Summary

DC Schemes

Scope and Summary

This note provides a practical summary of some key aspects relating to Defined Contribution (DC) schemes as at June 2021.

Takeaway points include:

- the move away from Defined Benefits (DB) schemes to DC schemes has increased in recent years, especially since automatic enrolment began;
- good governance of DC schemes has become a priority for the Pensions Regulator. There are governance requirements (for example chair's statements) which need to be borne in mind by trustees and employers; and
- the landscape in which DC schemes operate is changing with the introduction of master trusts, collective DC arrangements and cash balance schemes.

What are DC schemes?

- DC schemes are pension schemes where employee and employer contributions are invested and the pot is used to provide a pension and/or other benefits upon the employee's retirement. The value of the benefits paid out by the DC scheme ultimately depends on the amount of contributions paid in, the investment return realised after the costs of the scheme have been deducted and the cost of buying the pension and/or other benefits. The risk with DC schemes lies primarily with the member, whereas with a DB scheme the risk lies mainly with the employers.

- DC pension schemes will typically either be trust-based or contract-based. Trust-based schemes are governed by a trust deed and rules whereas contract-based schemes are governed by contracts agreed between members and pension providers. A growing proportion of occupational trust-based DC members have their pensions invested through authorised master trusts. Hybrid schemes include DC benefits as well as defined benefits. GPPs and Group SIPPs are also popular with employers.

- Since 2015 savers have more freedom to choose what they do with their "pot" and do not have to purchase an annuity. They can take benefits as a lump sum, through regular drawdown, or even pass them on to their family after their death. Where their original scheme does not provide the option desired, they can transfer their benefits elsewhere to benefit from the flexibilities.

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Legal Requirements

For a trust-based scheme regulated by the Pensions Regulator, some key requirements for a DC scheme (or a DC part of a scheme) generally include:

- where being used as an automatic enrolment vehicle, compliance with the relevant legislation. For example, the correct employees are enrolled and the minimum required level contributions are paid (by both employees and employers);
- producing an annual chair's statement which includes the matters required by legislation;
- calculating charges borne by members of the scheme (including transaction costs, if possible) at least once a year and assessing the extent to which those charges and costs represent good value for members. At the time of writing there are proposals for further development of these requirements for schemes below a certain size;
- reviewing the scheme's investment strategy (including the default strategy) and the performance of funds at least every three years;
- providing statutory annual benefit statements to members;
- maintaining a statement of investment principles and producing an implementation statement about its implementation and about the exercise of voting rights;
- maintaining a payment schedule in relation to contributions, and compliance with reporting requirements such as the scheme return and duties to publish certain information such as the implementation statement; and
- assisting members to make well-informed decisions, including protecting members from pension scams.

At the time of writing there are proposals to introduce requirements to add detailed climate change-related disclosures, starting with master trusts and the largest schemes.

Practical Steps

Employers should ensure that any chosen DC scheme complies and continues to comply with the automatic enrolment legislation.

Employers and trustees should work together to ensure compliance with the governance requirements imposed on DC schemes. Governance should be a standing item on trustee meeting agendas.

Since most of the risk lies with the saver, good member communications and engagement are important to help them engage with their retirement planning.

In Summary

Millions of UK employees are members of DC schemes, in part thanks to the transition to auto-enrolment. Due to the scale of membership of these schemes and the finances involved, the governance of these schemes has become a priority for the Pensions Regulator and, as such, there are ever increasing requirements on trustees and employers.

Appropriate administration and investment governance is crucial to achieving good member outcomes, along with member engagement. Trustees should be knowledgeable on their duties and legal obligations. If there is any doubt to the legal compliance of the scheme's governance, trustees should seek legal advice.

Please let us know if you would like further information or advice on anything in this note.