

Charges and Governance Requirements for Defined Contribution Pensions

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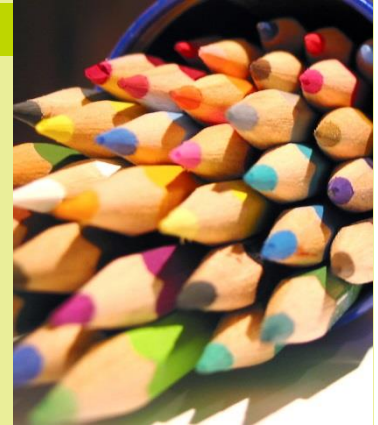
Pension briefing

HIGHLIGHTS

This note sets out the areas in which restrictions on charges and governance requirements apply to trustees or managers of occupational money purchase schemes. These requirements have been introduced over the last two years and some apply not only to defined contribution (DC) schemes but also to defined benefit (DB) schemes offering DC additional voluntary contributions (AVCs).

Hogan Lovells' pension team can help clients meet the requirements – for more information please speak to your usual pension contact or one of the partners listed at the end of this note.

For master trusts, new legislation will cause them to be subject to a detailed authorisation process and on-going scrutiny by the Pensions Regulator. The new provisions will catch non-associated multi-employer (NAME) schemes which provide money purchase benefits. For more information on this please see our January 2017 briefing [Authorisation of master trusts – problems ahead for NAME schemes?](#)



RESTRICTION ON CHARGES (OCCUPATIONAL DC SCHEMES OTHER THAN ARRANGEMENTS SOLELY PROVIDING AVCs)

Since April 2015 a charges cap has applied to default funds in schemes which are qualifying schemes for auto-enrolment purposes. Charging structures are prohibited unless they are:

- A "single charge structure" not exceeding 0.75% of the value of the member's fund annually; or
- A combination structure of an "existing rights charge" (applicable to the member's existing fund) and either a percentage charge on further contributions or a "flat fee" charge, each subject to prescribed limits.

Transaction costs (including property holding and maintenance) and costs associated solely with the provision of death benefits are excluded from the charges cap.

Trustees should note:

- For this purpose, a "default fund" is defined more widely than might be expected to mean both:
 - an arrangement to which workers' contributions are paid where the workers have not expressed an investment choice; and
 - where members have to make an investment choice, a fund to which, broadly, more than 80% of workers pay their contributions.
- Trustees may allow higher charges where the member has agreed in writing to pay for additional services.
- Where a money purchase arrangement is used by a qualifying scheme to fulfil an employer's auto-enrolment duties and falls within the default fund charges cap, any of

the employer's workers who choose to pay AVCs to the same arrangement will also be protected by the cap.

- Trustees have to confirm whether they comply with the charge controls in their annual scheme return.

BAN ON MEMBER-BORNE COMMISSION (ALL OCCUPATIONAL DC SCHEMES INCLUDING SCHEMES WITH DC AVCs)

Service providers for occupational pension schemes which provide money purchase benefits and which are being used as a qualifying scheme for auto-enrolment purposes are prevented from levying a charge on members to recover the cost of any commission paid to advisers for services in any new commission arrangements from 6 April 2016 (and in existing ones that are varied or renewed after that date).

The ban covers all money purchase benefits, not just default arrangements, and including AVCs under a qualifying scheme where they are used to provide money purchase benefits, even where they are the only form of money purchase benefit under the scheme. And it applies to all members (whether active or deferred) who are, or were, employed by the employer for whom the scheme is being used as a qualifying scheme, including those who were deferred before April 2016, or even before the scheme was first used as an auto-enrolment scheme.

Trustees should note:

- Although the duty to implement the ban is on providers rather than trustees, there is an obligation on trustees to inform firms providing administration services to them if their scheme is a qualifying scheme used for auto-enrolment. Trustees had three months from 6 April 2016 to give this confirmation. For future appointments of service providers, or where the scheme starts being used as an auto-enrolment qualifying scheme, confirmation

has to be provided within three months of the appointment/start of use.

- Trustees have to confirm in their scheme return whether or not the provider has, as required, told them that it is compliant with the ban.
- A scheme which is covered by the ban will continue to be covered, even if it subsequently ceases to be used as an auto-enrolment qualifying scheme.
- Members can opt-in to paying for advice and services subject to various conditions, including that there must be a written agreement which sets out (among other things) the cost and the period over which it will be deducted from the member's funds.
- The government plans to extend the ban to existing arrangements in due course. The Pensions Schemes Bill (currently before Parliament) will allow terms in contracts between pension scheme trustees and service providers to be overridden. Explanatory notes to the Bill suggest that this power may be used in relation to terms imposing member-borne commission or early exit charges (please see below).

ACTIVE MEMBER DISCOUNTS (ALL OCCUPATIONAL DC SCHEMES INCLUDING SCHEMES WITH DC AVCS)

From 6 April 2016, higher charges for non-contributing members of a "relevant scheme" than for contributing members are prohibited where:

- the member made at least one contribution on or after 6 April 2016;
- at that time, the member was a "worker" (for auto-enrolment purposes) of the employer; and
- also at that time, the scheme was a qualifying scheme in relation to at least some of the employer's jobholders.

Trustees should note:

- The prohibition on active member discounts applies to all money purchase funds in schemes which are auto-enrolment qualifying schemes. Potentially, this could extend to AVC funds offered by DB schemes, if the DB arrangement is used to meet the employer's auto-enrolment responsibilities for some or all of its jobholders.
- This does not prevent an employer from subsidising active members.

GOVERNANCE (OCCUPATIONAL DC SCHEMES OTHER THAN AVC ARRANGEMENTS)

The Charges and Governance Regulations 2015 introduced new requirements relating to administration and governance in respect of "relevant schemes". Broadly, "relevant schemes" for this purpose includes all money purchase occupational schemes except executive pension schemes, small self-administered schemes, public sector schemes and DB schemes where the only money purchase benefits are AVCS.

There are separate quality requirements for workplace personal pension schemes (contract-based schemes) introduced by the Financial Conduct Authority. Firms must establish independent governance committees (IGCs). IGCs have a contractual duty to act independently of the firm and in the interests of active and deferred scheme members.

The governance requirements for occupational DC schemes include the following.

- The scheme rules must not restrict the choice of service provider (a particular issue for master trusts and other relevant multi-employer schemes).
- If a trust scheme did not have a chair, the trustees were required to appoint one within three months of April 2015 (or of the date of establishment of the scheme, if later). The chair may be a professional corporate trustee.
- "Core financial transactions" (which include payments to members and transfers between investments) must be processed promptly and accurately.
- At least once a year trustees must assess whether charges and transaction costs borne by members represent value for money.
- The scheme's default fund must be reviewed every three years. The trustees must also prepare a statement of investment principles (SIP) for the default fund covering, among other matters, an explanation of how the fund's investment objectives are intended to ensure that the assets are invested in the best interests of the default fund members and their beneficiaries.
- An "annual governance statement" must be prepared within seven months of the end of each scheme year. The statement must cover a number of matters, including how the trustees have satisfied the knowledge and understanding requirements in the Pensions Act 2004. It must also give information on costs and charges applicable to funds in which members pots are invested.

Trustees should note:

- The annual governance statement must include information on costs in relation to all funds in which members' assets were invested in the scheme year. For the default fund, the level of charges and transaction costs must be given. For other funds, the range of the level of costs and charges must be stated.
- Where trustees are unable to obtain information about transaction costs, they should indicate this in the annual governance statement and should explain what steps are being taken to obtain that information in future.
- Failure to comply with the requirement to produce the annual governance statement automatically leads to a penalty of between £500 and £2,000. The Pensions Regulator has already imposed the maximum fine in some cases where the statement has not been produced. There is also a "name and shame" aspect to any breach – the Regulator issues press releases and regulatory intervention reports with details of the scheme and the fine imposed.
- Additional requirements apply to master trusts and other relevant multi-employer schemes.

THE PENSIONS REGULATOR'S CODE OF PRACTICE ON GOVERNANCE (ALL OCCUPATIONAL DC SCHEMES INCLUDING SCHEMES WITH DC AVCS)

The Pensions Regulator set out a new framework for regulating governance and administration of occupational trust-based DC schemes in its revised [Code of Practice 13: Governance and administration of occupational trust-based schemes providing money purchase benefits](#), accompanied by

six "how-to" Guides corresponding to each section of the Code:

- the trustee board;
- scheme management skills;
- administration;
- investment governance;
- value for members;
- communicating and reporting.

The revised Code, effective from 28 July 2016, is considerably shorter than the previous version, partly because of a deliberately different approach, but also reflecting the fact that (other than for AVC arrangements) there is now separate legislation on governance (see above).

In December 2016 the Pensions Regulator issued a response to its consultation on trustee scheme governance in the 21st century, confirming that it intends to:

- clarify the role and responsibilities of professional trustees, as part of consultation on its penalty policy;
- consolidate the current governance regime into overarching pieces of guidance to cover the issues common to all pension schemes;
- use tougher enforcement against failing trustees.

Trustees should note:

- The Code replaces both the previous version and its "31 quality features" standard scheme assessment template, although the new version of the Code does contain a "self-assessment template" tool to help trustees assess their scheme against the standards in the Code.
- The Code is not specific about how the standards might be met for AVCs. When the Guides were released, the Pensions Regulator commented that trustees should approach AVC schemes in a manner proportionate to the significance of the value of the AVCs relative to the members' overall benefits in the scheme (as opposed to the size of the AVC agreement relative to the scheme overall).

EARLY EXIT CHARGES (EXPECTED TO COVER ALL OCCUPATIONAL DC SCHEMES INCLUDING SCHEMES WITH DC AVCS)

The Pension Schemes Bill (currently before Parliament) will extend the powers in the Pensions Act 2014 to allow a cap to

be imposed on early exit charges for members of occupational pension schemes. The DWP issued a consultation response in November 2016 and a cap is expected to apply from October 2017, following consultation on draft regulations. The response gives some details of the proposed cap.

- The cap will apply to all charges imposed on members (aged between 55 and their pension age when seeking to access their pension pot early) which they would not face if they carried out the same transaction at the agreed pension age for their scheme.
- Charges associated with accessing one of the options for drawing benefits will not be "early exit charges" if they would apply whether the member was accessing the option at the scheme's agreed pension age or earlier.
- The intended cap on early exit charges from occupational schemes will be:
 - 1% for existing members; and
 - 0% for new members.
- Market value adjustments and terminal bonuses will not be included in the cap. However, the DWP comments that where there is a guarantee or "reasonable expectation" of a terminal bonus being paid, then for the purposes of the cap on charges, this should be treated as forming a part of the total value of the member's pot.

A similar cap on early exit charges will apply to stakeholder and personal pension schemes. The Financial Conduct Authority intends to bring rules containing the cap into force on 31 March 2017.

Trustees should note

- The primary duty to comply with the cap will fall on trustees or managers, or service providers, depending on who applies the charge in practice. Where more than one party applies an early exit charge, the cap will apply to the aggregate of the charges.
- It is not intended to require that the exit cap be disclosed to members, but this will be kept under review.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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