The Trustee toolkit downloadable

How a DC scheme works 2014

Tutorial one: Good member outcomes

By the end of this tutorial you will better understand:

- the risks to good member outcomes inherent in DC schemes
- the need to mitigate risks to good member outcomes

This tutorial is part of Scenario one.

Glossary

A detailed glossary of technical terms can be downloaded from the Resources tab when you log in at www.trusteetoolkit.com

The Pensions Regulator

Introduction

In a DC scheme each member has their own nominal pension fund or pot. The amount of pension a member receives cannot be determined until the member retires. It will be affected by:

- contributions
- the way investments have performed
- any costs and charges taken from the member's funds
- the way in which the member chooses to access their benefits

It will also be affected by issues such as:

- effective and efficient administration of the scheme
- value for money of services to the scheme
- appropriate decisions at pension age
- effective member engagement and communications
- effective management of advisers and service providers

Risks to good member outcomes

Throughout the rest of this module the tutorials will look at the issues affecting member outcomes.

Issue	Risk	More information
Appropriate contribution decisions	Member makes inadequate contributions: Many members are unaware how much they should contribute to meet their own expectations of an adequate income at retirement.	Tutorials 'Contributions' and 'Member communications'
Appropriate investment decisions	Member affected by investment risk: In a DC scheme, the investment risk is carried by the member, not the employer, and good investment governance and performance is one of the contributing factors to the value of the member's pot.	Module 'Investment in a DC scheme'
	Trustees offer poor or inappropriate investment choices for members: Trustees may select a default arrangement, or offer alternative investment options for members who choose their own strategy, which are not appropriate for the membership of the scheme leading to poor outcomes for members.	
	Member makes inappropriate investment choices: If members do not fully understand the characteristics of different funds and asset classes or the concept of risk and reward, they might select investment funds and/ or asset classes that are not appropriate for them. This is particularly important in schemes which do not offer a default fund.	
	Member affected by market volatility: Members of DC schemes also carry the risk of the volatility of the investments. The member's investments may collapse in value either at or near retirement date, just before the investments are switched within the scheme. At times of high volatility, members who carry out transactions, such as switching from one investment to another, carry significant risk of loss.	

Issue	Risk	More information
Value for members and charges	Member receives poor value: If the costs and charges deducted from members' funds or contributions are higher than you would expect given the scope and quality of the benefits and services provided to members then the scheme may not be providing 'good value'. When considering 'value for members', trustees should if possible compare components in the scheme to other options available in the market. 'Value for members' does not necessarily mean low cost. Trustees should be able to understand and demonstrate how higher cost services can add value for members.	Tutorial: 'Value for members and charges'
	Member affected by excessive charges: Except where an employer has agreed to pay some costs (for example administration costs), all or most of the charges on a DC scheme come out of the member's contributions or funds. High charges can have a major detrimental effect on a member's pension pot.	

Issue	Risk	More information
Effective and efficient administration	Member's contributions not paid to scheme accurately or on time: The employer is responsible for paying both their own and the members' contributions to the scheme. Trustees need to monitor the arrangements to the extent they are able to do so to ensure that this happens promptly and accurately.	The problems caused by administrative errors in the running of DC schemes can also be very significant. The cost of rectifying a problem for one member can cost many thousands of pounds. Administration errors can affect large numbers of members. Significant changes in how a scheme is used by employers could impact on the administration of the scheme. For example, if an employer decides to use a scheme as an automatic enrolment scheme, this could mean an increase in membership which poses a challenge to the scheme's operational capacity. Tutorial 'Transaction processing'
	Scheme transactional/ administration errors: Errors made in scheme administration can have a very significant effect on the size of a member's pot. For example, delays or mistakes during the processing of transactions may result in money remaining out of the market for too long and reduce the value of the member's funds.	
Appropriate decisions at pension age	Member makes poor decisions at pension age: In a DC scheme, after saving for what may be many years, it is up to members to decide how to use their pot when they reach the age at which they can access their benefits (pension age). In some cases, they may make inappropriate decisions for their own personal circumstances. Even if members make the most suitable decision about the type of product, they may fail to obtain the most competitive rates or choose the most appropriate product features.	Tutorial 'Decisions at pension age'
	Annuity rates (for those members taking an annuity): Annuity rates may drop just at the point when a member is about to buy an annuity. This may be because, for example, longevity is judged to be increasing, long term interest rates have dropped, or both.	

Issue	Risk	More information
Member communications	Lack of member understanding about pensions: If a member's overall understanding is poor or if the member is not engaged in relation to their pension pot, then it greatly increases a risk that they will not achieve a good outcome at pension age.	Tutorial 'Member communications'
	Member is targeted by scam: For example, ill-informed members may be targeted by a pension scam and transfer their funds to another arrangement in order to access their money before the age of 55. For most people the offers will be bogus and they could lose most, if not all, of their pension savings. As well as losing their savings, members may also have to pay tax as a result of taking an unauthorised payment from their fund.	
Managing advisers and service providers	Member affected by poor service from advisers or service providers: Many of the services to members are provided by advisers or service providers on behalf of the trustees. If these organisations do not provide the agreed service to trustees then this inevitably has an impact on the members.	Tutorial 'Managing advisers and service providers'

Risks to achieving good member outcomes

Good risk management for a scheme involves identifying, evaluating, controlling and monitoring the risks that are likely to have a material impact on the scheme's ability to deliver good member outcomes. You will find more information on this topic in the Tutorial: 'Risk management and internal controls' in the Module: 'Running a scheme'.

Understanding and evaluating risks

The tutorials in this module will focus on key areas in the governance and administration of DC schemes and the main risks inherent in running a DC scheme.

Controlling and monitoring the risks

Trustees have statutory and fiduciary duties in running pension schemes and your role is important in delivering good member outcomes. As part of good governance of the scheme, it is therefore essential that trustees put in place appropriate mitigation for those scheme risks that are identified.