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Key findings from the Pensions Regulator's survey of trust-based defined contribution pension schemes

The Regulator's latest survey report into defined contribution (DC) pension schemes focuses on how well trustees are meeting key governance requirements.

The results continue to suggest that, overall, governance standards are increasing; however, trustees need to demonstrate better understanding of their own membership and smaller pension schemes are generally not meeting the governance standards expected by the Regulator.

Background

The survey sought to understand the extent to which trustees of DC schemes were meeting:

- key governance requirements, and to monitor any changes over time; and
- the Regulator's expectations, as set out in the code of practice on the governance and administration of trust-based pension schemes providing DC benefits.

The survey covered 430 single-employer schemes and 17 master trusts. (For the purposes of the survey, hybrid schemes were instructed to answer questions only in relation to the DC section of their scheme.)

Single employer pension schemes are grouped by size:

- Micro schemes are defined as schemes with 2-11 members;
- Small schemes with 12-99 members;
- Medium schemes with 100-999 members; and
- Large schemes with 1,000+ members.

Schemes with multiple employers are defined as master trusts in the report regardless of membership size.

Key governance requirements

The Regulator has assessed schemes against the following key governance requirements (KGRs) that DC schemes are subject to:

Number	Requirement
KGR 1	Trustee boards must possess or have access to the knowledge and competencies necessary to properly run the scheme
KGR 2	Trustee boards must assess the extent to which charges/transaction costs provide good value for members
KGR 3	Core scheme financial transactions must be processed promptly and accurately
KGR 4	Trustees of master trusts must meet independence requirements
KGR 5	Trustee boards must ensure the default investment strategy is suitably designed for their members (applicable only to schemes with a default investment strategy)

Meeting the individual KGRs

- 71% of members were in schemes that met all their applicable KGRs (up from 54% in 2018).
- 97% of members were in a scheme that met KGR 1 (unchanged from 2018).
- 80% of members were in a scheme that met KGR 2 (down from 86% in 2018).
- 85% of members were in a scheme that met KGR 3 (up from 63% in 2018).
- 98% of members were in a scheme that met KGR 4 (down from 99% in 2018).
- 90% of members were in a scheme that met KGR 5 (down from 95% in 2018).

Meeting the individual KGRs by scheme size

There is a clear disparity between the results for small and micro schemes and larger schemes. (2018 figures are shown in brackets.)

	Overall	Micro	Small	Medium	Large	Master Trust
Proportion of schemes that met KGR 1	27% (32%)	16% (24%)	24% (31%)	67% (72%)	82% (86%)	100% (100%)
Proportion of schemes that met KGR 2	16% (25%)	12% (24%)	8% (12%)	41% (33%)	47% (49%)	47% (45%)
Proportion of schemes that met KGR 3	18% (23%)	11% (18%)	12% (22%)	50% (42%)	58% (58%)	71% (60%)
Proportion of schemes that met KGR 4	N/A	N/A	N/A	N/A	N/A	88% (75%)
Proportion of schemes that met KGR 5	28% (27%)	14% (19%)	26% (21%)	55% (51%)	79% (77%)	76% (89%)

Main barriers to meeting the KGRs

Schemes had to report on how they met each of the constituent measures making up the KGR. There were between five and six measures for KGRs 1 to 3, four measures for KGR 4 and three for KGR 5. For the measures that had the lower scores these were assessed as barriers to meeting the KGR.

KGR		Constituent measures
1	Knowledge and understanding	Having training and development plans in place to ensure trustees continue to have the required knowledge and skills (primarily among smaller schemes) New trustees completing the trustee toolkit or an equivalent within six months of their appointment (primarily among smaller schemes)
2	Value for members	Researching and taking account of what members value
3	Core financial transactions	Tracking performance against service standards for the time taken to process core financial transactions and their accuracy (primarily among smaller schemes and because they did not have service standards in place)
4	Independence requirements	Having a process in place for members to make their views known to the trustee board (master trusts only)
5	Suitable design of default investment strategy	Use of member analysis or research in the design of the default investment strategy (primarily among smaller schemes but also impacting on medium schemes)

Meeting the expectations set out in the DC code of practice

The survey also analysed the extent to which schemes were meeting the standards that the Regulator expects trustee boards to meet when complying with the KGRs and other legal duties, as set out in the DC code of practice.

The following table sets out the proportion of different sized schemes that are meeting the Regulator's expectations in seven areas. (2018 figures are shown in brackets.) Although the DC code of practice is divided into six sections, the Regulator's survey considered managing commercial relationships separately, even though it is contained within the section on scheme management skills in the code.

	Overall	Micro	Small	Medium	Large	Master Trust
The trustee board	38% (40%)	31% (35%)	37% (40%)	61% (63%)	73% (73%)	100% (80%)
Scheme management skills	55% (59%)	48% (54%)	54% (61%)	82% (82%)	92% (92%)	99% (97%)
Managing commercial relationships	34% (38%)	27% (31%)	32% (39%)	66% (75%)	78% (80%)	75% (83%)
Administration	25% (31%)	15% (25%)	25% (26%)	63% (60%)	71% (73%)	90% (87%)

	Overall	Micro	Small	Medium	Large	Master Trust
Investment governance	22% (23%)	17% (19%)	20% (14%)	45% (39%)	53% (55%)	59% (62%)
Value for members	56% (60%)	51% (58%)	52% (52%)	82% (74%)	83% (83%)	86% (87%)
Communicating and reporting	58% (63%)	55% (62%)	53% (56%)	72% (69%)	80% (78%)	75% (81%)

(Details of the criteria schemes would have had to meet to achieve a score of 100% for each of these areas of the code are set out in Annex A of the report.)

Other governance considerations

Cyber security risks

Schemes were asked about nine specific controls to protect their data and assets from cyber risk, and overall 72% had more than half of these in place. Of all the cyber controls, schemes were most likely to have system controls and access restrictions in place (80%) and regularly back up critical systems and data (80%). Schemes were least likely to have cyber risk included on their risk register (32%), mainly because small and micro schemes did not have a risk register. (85% of schemes that had a risk register included cyber risk on their register.)

Overall, 14% of schemes reported experiencing some form of cyber attack or breach in the previous 12 months. This proportion was relatively consistent across the different sizes of single employer scheme. Across all sizes of scheme, the most common cyber breaches/attacks were staff receiving fraudulent emails or being directed to fraudulent websites. The most common impacts were online services being disrupted and temporary loss of access to files or networks. 1% of all schemes reported that personal data had been altered, destroyed or taken.

Taking account of climate change in investment strategies

Overall, only 21% of schemes with at least 100 members and/or used for automatic enrolment had considered climate change in their investment strategies, although these schemes covered 82% of DC members. The main reason for not considering climate change was that it was not felt to be relevant to their scheme, it was felt it was not required, or there were other priorities/limited time.

Consideration given to winding up

Overall, 19% of single employer schemes reported that they had considered winding up, including 43% of small schemes.

The main reasons given for considering winding up were the time and cost involved in running the scheme and a perception that it did not provide value for its members. The main barriers to winding up were felt to be time constraints, employer affordability and the difficulty in locating members or obtaining their consent for benefits to be secured in an alternative scheme.

Commentary

The survey gives clear evidence of the Regulator's increased expectations of DC scheme trustees and indicates that there is still plenty of room for improvement, particularly in better understanding of the membership and what they value. There is also clearly work to do in terms of investment governance, and it is to be hoped that the current reforms around statements of investment principles will go some way to achieving this.

The research also supports the Regulator's view that smaller schemes generally have less effective governance than larger schemes, with a corresponding risk to value for members and outcomes. The Regulator has been very vocal about benefits of scale, their belief that the majority of smaller schemes would benefit from consolidating with larger schemes and some frustration about the slow pace of consolidation.

Small and micro schemes, will therefore continue to face pressure to reform, consolidate or wind-up and recent changes in legislation now make it easier for trustees to facilitate the bulk transfer of members without consent. It will be interesting to see whether this is reflected in next year's report.

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