PENSIONS AND
LIFETIME SAVINGS
ASSOCIATION

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ASSESSING GOOD VALUE FOR MEMBERS

A GOOD PRACTICE GUIDE

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TIM SMITH is a senior associate professional support lawyer in Eversheds market leading pensions team, where he provides technical support and training to Eversheds' UK and international pensions team and to clients. Tim has particular expertise in relation to UK and EU pensions policy, the UK pensions tax regime, pension scheme governance and automatic enrolment. Tim has been helping trustees of DC schemes and members of IGCs as they decide how to assess and report on *good value*/value for money for the first time.

HOW TO USE THIS GUIDE

This guide represents the Pensions and Lifetime Savings Association's contribution to the evolving debate in assessing value in occupational pension schemes. It has been designed to aid trustee thinking in this area, offering practical considerations and pointers on conducting the assessment. It does not constitute legal advice or an authoritative list of considerations for discharging trustee responsibilities in undertaking the *good value* assessment.

The Pensions and Lifetime Savings Association would like to thank Eversheds for their support and contribution to this guide.

INTRODUCTION

On 6 April 2015 amendments to the Occupational Pension Schemes (Scheme Administration) Regulations 1996 came into force, introducing new governance requirements for trustees of defined contribution (DC) occupational pension schemes. With automatic enrolment well underway these changes have been designed to drive up the quality of governance in qualifying schemes and ensure that members get value for money.

At the heart of these new requirements is a duty for trustees of schemes that provide money purchase benefits, at least annually, to:

- calculate the charges and, insofar as they are able to do so, the transaction costs, borne by members of their scheme which relate to such benefits, and
- assess the extent to which those charges and transaction costs represent *good value* for members.

Trustees are required to detail the level of charges and transaction costs under their scheme and explain the outcome of their *good value* assessment in a new Chair's annual governance statement.

Although trustees are under a legal duty to assess the extent to which member-borne costs and charges under their scheme represent *good value*, there is no statutory definition of what *good value* means. There is also limited regulatory guidance currently available on this.

Consequently, the question of what constitutes *good value* and how trustees should assess this under their scheme has prompted much debate within the pensions industry. Similar questions are also being debated in the context of the new independent governance committees, which have recently been established to scrutinise the value for money of workplace personal pension plans.

This paper explores these issues and seeks to assist trustee boards as they decide how to assess and report on the value delivered by their scheme.

APPLICATION TO AVCS

The requirement to assess whether member-borne costs and charges represent *good value* does not apply to a scheme where the only money purchase benefits are additional voluntary contributions (AVCs).

However, where a scheme provides money purchase AVCs and other money purchase benefits the requirements will apply to all of the money purchase benefits under the scheme, including the AVCs.

Therefore, trustees of hybrid schemes which have money purchase AVCs will need to assess the value of member-borne costs and charges relating to the AVCs as well as those relating to the other money purchase benefits under the scheme.

DEFINING GOOD VALUE

The National Audit Office broadly defines value for money as an 'optimal use of resources to achieve the intended outcome'. This recognises that assessing value requires an analysis of the costs and benefits associated with the relevant activity.

This approach is reflected in a pensions context in the Pensions Regulator's draft new DC Code of Practice. In the draft Code, the Regulator says that a scheme is likely to represent '*good value* for members' where:

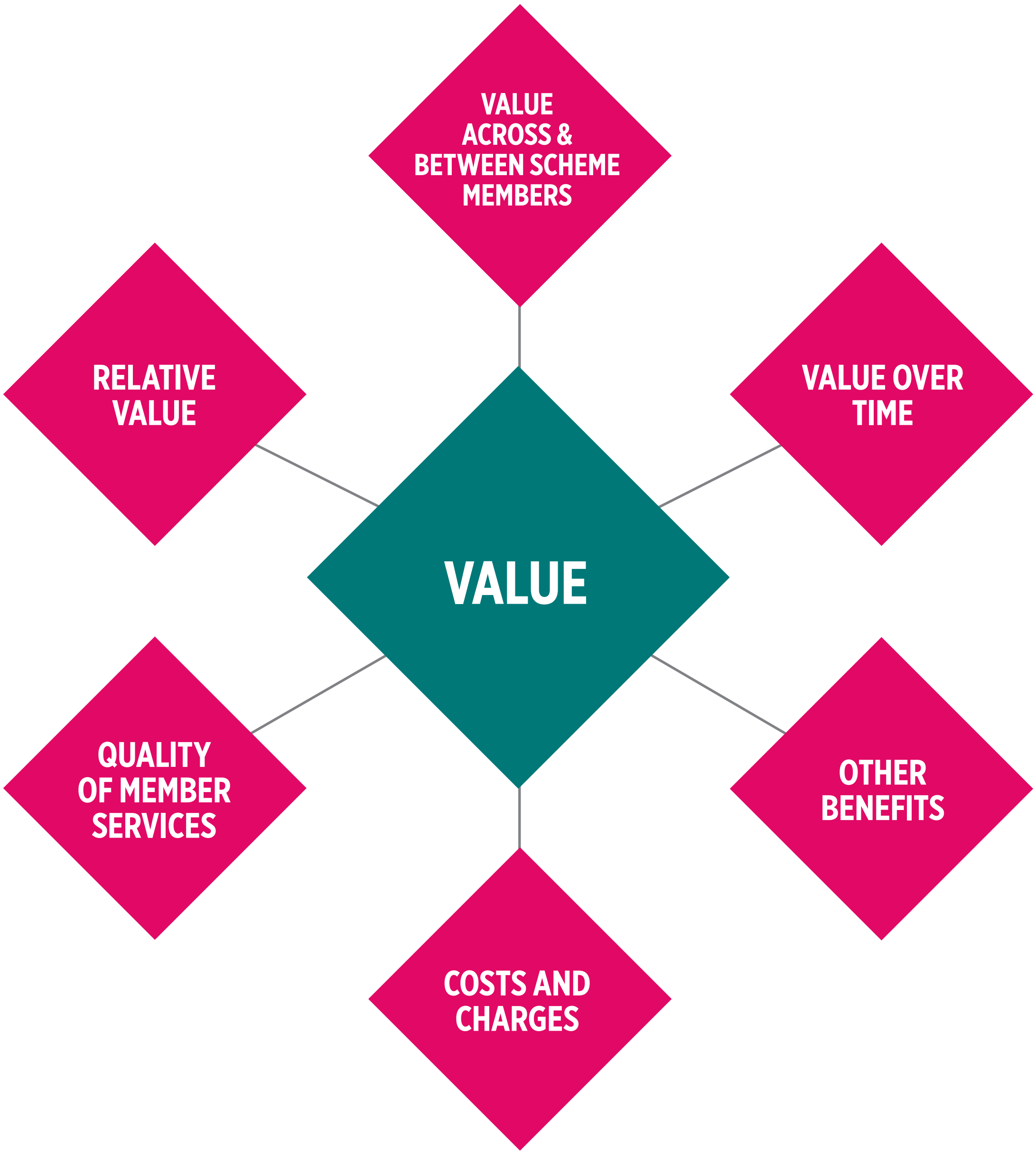
'the combination of costs and what is provided for the costs is appropriate for the scheme membership as a whole, and when compared to other options available in the market'

As this definition recognises, assessing value is not simply a question of cost. It also requires an assessment of the benefits and services provided for the relevant spend. Under a DC workplace pension scheme, most member-borne costs and charges are related to services provided to scheme members, such as administration, governance, investment and communications. Assessing the quality and relevance of those services for members will be a key part of the *good value* assessment.

As the Regulator's draft DC Code suggests, value cannot be assessed in a vacuum. Therefore, in order to properly assess the value of their scheme, trustees ought to:

- compare the member-borne costs and charges under their scheme with other schemes available in the market; and
- assess the competitiveness of the amount that they pay for particular services.

The costs and charges borne by members are likely to vary across the period of an individual's membership of the scheme. They are also likely to be affected by member behaviour. Therefore, trustees will need to assess value over the long-term and they will need to consider the impact of member behaviour, such as a member deciding to switch investments, cease contributing or transfer out of the scheme.



DEFINING GOOD VALUE

Assessing *good value* involves a subjective judgment on the part of trustees and there is no single right answer. However, it is important that trustees are able to:

- demonstrate that they have followed a suitable and thorough process;
- show that they have taken account of all relevant factors in making their assessment, and
- justify the outcome of their assessment.

In our view, and based on discussions with members and the Regulator, assessing the value under a pension scheme involves the following steps:

STEP 1
Set out your approach

STEP 2
Identify costs and charges

STEP 3
Assess benefits/quality

STEP 4
Benchmark

STEP 5
Take remedial action

STEP 6
Record outcomes and report

TOP TIPS

Top tips for trustees undertaking the *good value* assessment:

1. **BE CLEAR IN YOUR APPROACH.**
   Outline how you will assess *good value* and the information that you need in order to do this.

2. **PREPARE.**
   Liaise with your service providers in advance and ensure there is sufficient time to collect and analyse relevant data and to get your Chair's statement signed off.

3. **ENSURE YOUR ASSESSMENT IS TRANSPARENT AND CLEARLY EVIDENCED.**
   The assessment process should be transparent and thorough, with a contemporaneous record kept of the approach adopted, the factors considered and the outcome of the assessment.

4. **KEEP YOUR APPROACH UNDER REVIEW.**
   A *good value* assessment is required in every annual Chair's statement. It will be important to ensure your approach remains responsive both to the changing legislative environment and to developments in the *good value* debate.

1.
SETTING OUT YOUR APPROACH

THE FIRST STEP FOR TRUSTEES IN UNDERTAKING THE GOOD VALUE ASSESSMENT WILL BE TO DECIDE THEIR APPROACH. TRUSTEES SHOULD IDENTIFY THE FACTORS THEY WILL NEED TO CONSIDER AS PART OF THE ASSESSMENT AND HOW THESE SHOULD BE MEASURED. THEY WILL ALSO NEED TO IDENTIFY THE INFORMATION THAT THEY WILL REQUIRE AND TAKE STEPS TO OBTAIN THIS INFORMATION.

Trustees may want to draw up a *good value* policy in which they record how they will approach the *good value* assessment and the factors that they consider relevant to this. This policy would serve as a helpful summary of the trustees' approach and could be reviewed and updated each year to reflect changes in the law and regulatory guidance as well as developments in the scheme and the wider pensions market.

The quality and relevance of the scheme's services to members will need to be considered as part of the *good value* assessment. This is likely to involve analysis of the needs and desires of the scheme's members as well as members' feedback on current services. Factors such as the demographic profile of the membership (including salary profile), members' appetite for risk and expected member behaviours will also be relevant.

Trustees will need to decide how to obtain feedback from members and how to identify members' needs and preferences. This could be done in a variety of ways, including member surveys, workshops or focus groups.

Trustees will need to critically appraise any member feedback received and decide how much weight to attribute to this as members may attribute high value to things that do not have a significant impact on good member outcomes and low value to things that do.

2.
IDENTIFYING COSTS AND CHARGES

ONCE TRUSTEES HAVE ESTABLISHED THEIR APPROACH, THEY SHOULD AIM TO IDENTIFY THE FULL RANGE AND LEVEL OF COSTS AND CHARGES UNDER THEIR SCHEME, INCLUDING TRANSACTION COSTS. TRUSTEES WILL ALSO NEED TO UNDERSTAND THE EXTENT TO WHICH THESE CHARGES MAY VARY (FOR EXAMPLE, ACROSS DIFFERENT TYPES OF MEMBERS OR BASED ON A MEMBER'S FUTURE BEHAVIOUR). WHERE THIS INFORMATION IS NOT READILY AVAILABLE, TRUSTEES SHOULD TAKE STEPS TO OBTAIN IT FROM RELEVANT THIRD PARTIES.

As well as looking at the headline rate of charges under their scheme, trustees should also seek to unpack bundled charges into their component parts to understand what each component relates to. They should then assess the extent to which each component represents *good value* in its own right.

MAPPING THE DISTRIBUTION OF COSTS AND CHARGES

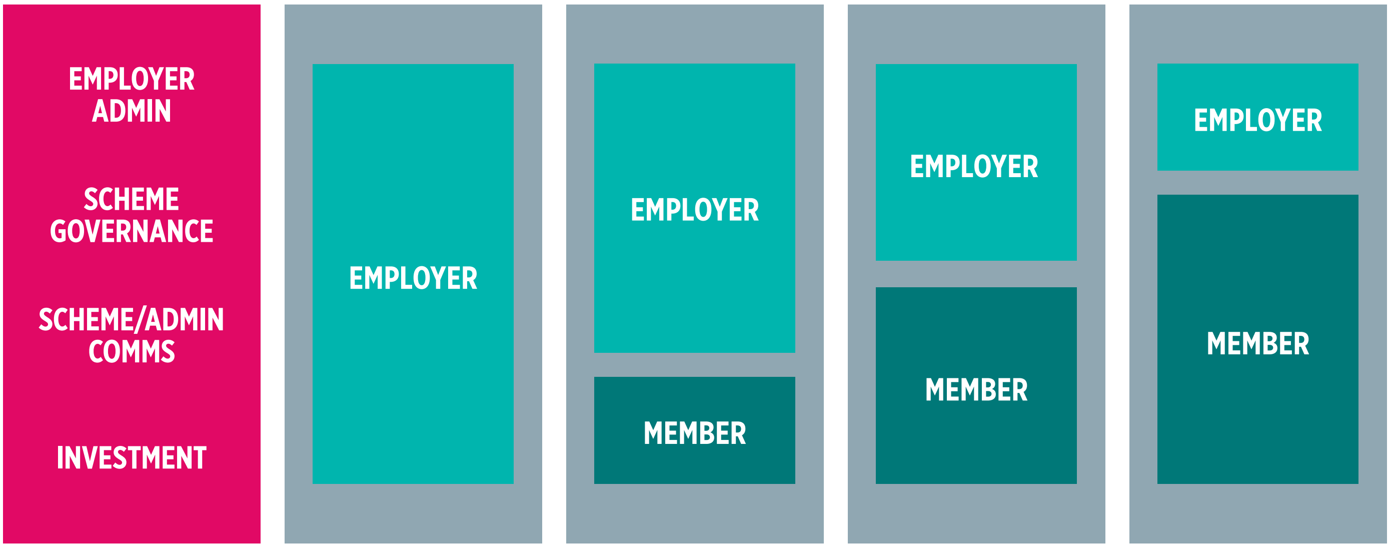
Costs and charges across and between scheme members

Most DC pension schemes operate on the basis that members with larger funds cross-subsidise those with smaller funds. Consequently, some members will be paying considerably more than others for the same services. While the presence of cross-subsidies within a scheme is not an indication of bad value in itself, trustees should set out clearly how they are used and their justification for using them. In doing so, they should remember that, as well as cross-subsidising other members, individuals with large funds are also likely to be cross-subsidising themselves for their early years of membership in which they are likely to have paid much lower charges.

The distribution of costs and charges between employer and member

Equally, it will be important for trustees to consider how any costs in their scheme are split between the employer and the member. The Regulator has indicated that trustees should clearly set out the basis of cost-sharing in their explanation of their *good value* assessment in the Chair's statement. While the law does not require trustees to analyse the costs in a scheme met by the employer, this can form an important part of building a full picture of the benefits offered by a scheme. It is also in everyone's interests to ensure a pension scheme represents *good value* for the employer as well. Therefore, as part of a well-run scheme trustees ought to have regard to this.

While there are many different cost-sharing models across the sector, the Pensions and Lifetime Savings Association's analysis has identified four different cost recovery models in trust-based DC schemes in which costs and charges are balanced differently across members and employers. These are displayed in the chart below.



It is important that trustees understand the cost model of their scheme so that they are clear who bears the various costs under the scheme. Understanding this will enable trustees to benchmark the costs and charges under their scheme against other schemes effectively.

For example, it would be inappropriate for a scheme where members pay only for investment management but not administration and governance services to directly compare headline member charges with a scheme where members pay for all of those services.

3.
ASSESSING BENEFITS/QUALITY

ONCE TRUSTEES HAVE IDENTIFIED THE COSTS AND CHARGES UNDER THEIR SCHEME THEY WILL NEED TO IDENTIFY THE SERVICES TO WHICH THESE COSTS AND CHARGES RELATE, HOW THESE SERVICES BENEFIT THE MEMBERS OF THEIR SCHEME AND HOW THEY CONTRIBUTE TO GOOD MEMBER OUTCOMES. TRUSTEES SHOULD ALSO IDENTIFY ANY OTHER BENEFITS ASSOCIATED WITH BEING A MEMBER OF THEIR PARTICULAR SCHEME.

Assessing member services

The principal services provided by a DC occupational pension scheme and related fees are:

COMMUNICATION

Member communication fee

INVESTMENT

Fund/investment management fees
Investment consultant fees
Ongoing charges for underlying funds
Depositary & custody fees
Transaction costs

GOVERNANCE

Fees paid to governance bodies
Governance charges e.g. insurance

ADMINISTRATION

Registration & regulatory fees
Payments to advisers, actuaries & lawyers
IT & other record keeping costs
Administrator fees

Determining the benefit of these services to members will involve assessing the quality of these various services. Trustees need to decide how they will do this and, inevitably, this will involve different considerations for different services.

Administration

Assessing the quality of scheme administration will involve consideration of the trustees' overarching objectives for the administration of the scheme. For example, is the objective simply to ensure compliance with the legal minimum requirements or is it to deliver a high-quality, efficient service for scheme members? Trustees should identify their objective and how this stands to benefit scheme members.

In addition, trustees will also need to assess the scheme administrator's performance. Relevant factors here will include:

- the extent to which the administrator is meeting the agreed service level standards;
- the quality of those standards (for example, a 95% success rate against a stringent standard may represent better performance than a 100% success rate against a poor standard);
- the extent to which core financial transactions in their scheme are administered promptly and accurately;
- the quality of scheme data; and
- member feedback and complaints.

Communications

The quality, quantity and distribution method of the communication strategy established by the trustees will affect communication costs. Where these costs are borne by members, trustees should be clear about both the benefits and costs of their strategy and seek to satisfy themselves that the members are getting *good value* for the money they are spending.

A scheme's communication strategy can have a significant bearing on member engagement, the ability of members to make informed decisions and members satisfaction with their retirement saving journey.

Consequently, trustees ought to identify the objectives of their communication strategy and measure the success of their communications in achieving those objectives.

Trustees should also review the length, style and frequency of their communications as well as the methods of delivery in considering how engaging and accessible their communications are for members.

The timing of member engagement is also relevant to this.

ASSESSING THE QUALITY OF MEMBER COMMUNICATIONS

To achieve accreditation under the Pension Quality Mark, the industry standard which employers can use to demonstrate the benefits of their pension scheme, schemes must provide 'clear, engaging and easy to understand' communications, with communications taking place at the following three specified stages of membership:

1. At induction/joining, employers or schemes should provide engaging information that emphasises the scheme benefits and the need to take action.
2. On an ongoing basis, employers or schemes should offer face-to-face or over-the-phone (such as group seminars, 1-2-1s or a helpline); or tailored individual information (such as access to a pension account online); or regular generic information (such as a newsletter or up-to-date intranet site).
3. When an employee nears retirement, employers or schemes should ensure they receive information to help them consider their retirement options.

The language used in communications issued by a scheme is also important. Trustees appraising the quality of their communications may want to compare the language used with the Department for Work and Pensions' *Automatic Enrolment and Pensions Language Guide* to ensure that their communications are as clear, engaging and as easy to understand as possible. This should be kept under regular review.

Governance

In many schemes, the costs of governance, such as adviser fees, fees for a professional trustee and training costs, will not be borne by the member. However, where members do bear these costs, once again, trustees need to identify them, understand them and weigh them against the benefits that the related services deliver to members.

ASSESSING SCHEME GOVERNANCE

Appraising a scheme's governance structure can pose practical challenges for trustees. The Pension Quality Mark suggests that headline governance standards can be attained provided that each of the following four requirements are met:

1. Trustees regularly discuss the DC pension scheme at their meetings;

2. EACH of the following three requirements are met:
   - independent trustees must be in the majority or an independent trustee company must have a casting vote;
   - trustees must have the power to make all investment decisions and to make, break or vary arrangements with all the scheme's investment fund managers, and with any administration service providers;
   - the chair of the main trustee body must be an independent trustee;

3. Trustees undertake training or learning that meets the relevant DC sections of The Pension Regulator's Code on trustee knowledge and understanding; and

4. Trustees review key issues relating to how well the scheme is run and whether it is meeting employees' needs.

As part of this assessment, the composition of the trustee board and mechanisms for collating members' views should be set out and assessed. Trustees should also satisfy themselves that there is sufficient transparency and oversight in their scheme.

To assist in carrying out this assessment, trustees could also ask their advisers how their scheme's governance arrangements compare with those in other similar schemes.

Investment

In order to assess the quality of a scheme's investment funds, trustees will need to consider:

- the suitability of their scheme's default investment fund and the extent to which it meets the needs of the members of their scheme, is reasonably priced and is appropriate for members' appetite for risk;
- the suitability of the other investment funds under their scheme and the extent to which they meet the needs of the members of their scheme;
- the performance of the default fund and the other investment funds under their scheme and how this compares to the aims and objectives of the various funds;
- the clarity and measurability of the investment objectives for the default fund and the other investment funds;
- the security of the assets, and
- the range and level of transaction costs.

Breaking down the costs and charges incurred by the member through investment choices can present some practical challenges for trustees. In the case of pooled funds, separating out costs can be problematic. It is important that trustees in their capacity as informed purchasers acting in the best interests of their members are able to understand and assess the costs of participating in a pooled fund and the value offered by it. However, trustees should take a proportionate approach, drilling down to an appropriate level of granularity for their scheme.

As part of their assessment of the value of scheme investments, trustees are required to assess, where possible, the transaction costs incurred as a result of buying, selling, lending or borrowing of investments. Where information on transaction costs is not readily available trustees should take steps to obtain this from relevant third parties.

Where possible, trustees should offer their members investment choice. However, too much choice can be counterproductive. As the investment standards set out in the Pension Quality Mark recognise, a limited choice of risk-related funds should be made available to members, accompanied by advice and guidance where possible.

4. BENCHMARKING

AS WELL AS ASSESSING THE VALUE WITHIN A SCHEME, TRUSTEES SHOULD SEEK TO DEMONSTRATE THAT THEY HAVE SOUGHT TO EVALUATE THE VALUE OFFERED BY THEIR SCHEME IN A RELATIVE CONTEXT. WHILE THE ASSESSMENT DOES NOT DEMAND EVIDENCE THAT A SCHEME OFFERS THE 'BEST' VALUE AVAILABLE, BENCHMARKING CAN SERVE AS A USEFUL BAROMETER FOR THE VALUE OFFERED BY A SCHEME. HOWEVER, BENCHMARKING WILL ONLY OFFER MEANINGFUL COMPARISONS WHERE SUFFICIENT DATA IS AVAILABLE AND TRUSTEES SHOULD BE MINDFUL OF TAKING A PROPORTIONATE APPROACH, ESPECIALLY WHERE EXTRA COSTS WILL BE INCURRED.

As outlined above, it is important that as far as possible trustees compare their scheme to others with a similar cost-sharing model in place. Although an exact like-for-like comparison may not always be possible, understanding how their scheme compares to similar schemes in the market will provide a valuable dimension to the *good value* assessment. Comparing the headline costs and charges under their scheme, and the benefits they deliver, with potential alternative workplace pension schemes that are available in the market, such as leading master trusts or group personal pension plans, would also provide a useful measure of the relative value of their scheme for their members. As well as benchmarking the costs, charges and benefits under their scheme with those applied by other schemes, where appropriate, trustees should also consider testing the value of their scheme by benchmarking the amount that they pay for particular services, such as administration or investment management against the fees of alternative service providers. Trustees would not be required to simply go with the cheapest service provider, but it would enable them to test the relative value of their services and to consider whether any additional fees that their scheme pays are justified by the quality of the service that is provided and the overall benefit to members.

Similarly, in the context of investments, from time to time, trustees should compare the costs and charges associated with the various investment funds under their scheme with other funds available in the market with similar objectives.

5. TAKING REMEDIAL ACTION

WHERE TRUSTEES, HAVING CARRIED OUT THEIR GOOD VALUE ASSESSMENT, CONSIDER THAT ONE OR MORE ELEMENTS OF THEIR SCHEME IS NOT DELIVERING GOOD VALUE TO MEMBERS THEY SHOULD, AS FAR AS POSSIBLE, TAKE REMEDIAL ACTION TO ADDRESS THIS.

For example, if trustees do not think that the quality of their communications or the performance of a particular investment fund is good enough they should take steps to remedy this. Similarly, if a benchmarking exercise reveals that trustees are paying over the odds for a particular service, trustees could address this by negotiating a better deal with their existing provider or switching to an alternative service provider.

Where it is not possible for the value for members to be improved, the Regulator has indicated that trustees should document the reasons for this. In order to demonstrate that their scheme is delivering *good value* on an ongoing basis, trustees should ensure that they are seeking to obtain the best deal for their members from their service providers and that they are reviewing this regularly.

6. RECORDING AND REPORTING

IN ORDER TO EVIDENCE COMPLIANCE AND AS PART OF GOOD GOVERNANCE, IT IS ESSENTIAL THAT TRUSTEES KEEP A RECORD OF THE OUTCOME OF THEIR GOOD VALUE ASSESSMENT AND THE PROCESS BY WHICH THEY ARRIVED AT THAT OUTCOME, INCLUDING THE FACTORS CONSIDERED.

The Regulator has indicated that trustees should keep a record of the individual or department they have used as part of their information gathering exercise from relevant parties, including service providers, investment managers and other advisers. In addition, trustees are expected to record any problems they encounter in obtaining relevant information and the steps they are taking to obtain that information in the future. Setting this out in a *good value* policy could be a helpful way of collating this information. This policy could then be reviewed on a regular basis and updated as necessary.

Trustees need to include details of their *good value* assessment and all member-borne costs and charges under their scheme in their Chair's Statement, which will form part of the scheme's annual report and accounts. As part of this, trustees should consider including details of specific actions that they have taken to ensure their scheme delivers *good value* and ongoing measures that are in place to help ensure this, such as regularly reviewing the suitability and performance of the scheme's investment strategies, benchmarking against other schemes and regularly reviewing the value delivered by service providers.

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