Trustee toolkit downloadable

Investment in a DC scheme
Scenario 2 of 2

In this scenario the investment sub-committee meet again to discuss the last quarter's performance of the investment options they are monitoring more closely. They also look at the charges of these options and make further recommendations to the board as a result.

By the end of this scenario and tutorials you will better understand:

- who pays the charges for investment in a DC scheme
- what the annual management charge (AMC), total expense ratio (TER) and portfolio turnover rate (PTR) are
- other investment charges that may be applied
- ways of reducing member borne costs
- what 'net of fees' performance means in relation to value for members
- factors to consider when reviewing the investment strategy and investment performance
- steps trustees may be able to take to withdraw or replace an investment option including communicating to members
- what 'out of market' risk is and ways of mitigating it.

This scenario and tutorials are related to the following units in the defined benefit (DB) and defined contribution (DC) scope guidance:

- How DC occupational arrangements work (7a)
- Measurement of performance using indices, benchmarks and targets (9d)
- The mechanisms for monitoring investment arrangements and fund managers (9e).

This scenario is linked to the **Charges** and **Managing performance** tutorials.

The Pensions Regulator

The agenda

You've been sent the agenda and papers for the next meeting of the investment sub-committee.

1. Apologies
2. Conflicts
3. Minutes of the last meeting
4. Performance and costs review
5. Recommendations report
6. Any other business

The papers attached to the agenda include the latest performance figures, net of fees.

You're pleased to see that the default arrangement performance has improved in the last quarter, but there are still problems with the actively managed funds.

The investment strategy for the default arrangement

The sub-committee finishes the standing items on the agenda quickly and begins to discuss the improving performance of the default investment arrangement.

John comments: 'Well, I for one am very pleased to see performance has improved over the last quarter.'

Charlotte replies: 'Yes it is good news, but it's only for three months. I'd like to continue monitoring the performance for longer.'

Brian says: 'I think that is a sensible idea, Charlotte. The performance has never gone below the benchmark, looking at these charts, and although it hasn't achieved its objective more recently, it's the long term view that's important here.

However, I think that there may be scope to negotiate the charges with the investment managers. Over 70% of the membership is invested in the default arrangement and there is now a significant size of assets under management.'

Charlotte says: 'I've been thinking the same Brian. We should be considering whether the investment options offer good value for members. This is one of the areas we have a legal obligation to assess and report on in the annual chair's statement for the default arrangement. Regardless of that obligation, good value for money is important to help our members see good outcomes from their pension savings. The charges are a little higher than I would expect and I know that other trustees have been successful in renegotiating charges.'

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Decision point: Charges and value for members

The sub-committee continue to discuss the charges for the default arrangement and different types of charges. Which of the following statements made are correct?

1. Costs and investment management charges are usually higher for passive managed funds than for the equivalent actively managed funds
2. If the scheme offered the range of investment funds via a platform then there may be an additional charge for the platform services which is normally passed on to the member
3. Some funds may be dual priced which means the selling price of the investment is lower than its buying price
4. The scheme could offer white-labelled funds, as without a brand name, the costs will always be lower.

Turn to the back for the answer.

The alternative options

The sub-committee agrees to make the recommendation to the trustee board to continue monitoring the performance of the investment strategy for the default arrangement and to start discussions with the investment managers to renegotiate the costs. The conversation turns to the alternative options.

John comments: 'Unfortunately we have less positive news regarding the underperforming actively managed funds. In particular, the Global Equity Managed Fund has seen the performance deteriorate even further in the last quarter.'

Brian adds: 'I've been looking at the longer term performance of all of the funds under closer monitoring and it is the Global Equity Managed Fund I have the most concerns about.

It has never achieved the objective set by the investment managers and over the past three years has quite often been underperforming the benchmark too.'

Charlotte says: 'Looking at the charges, it doesn't look like there is much scope there for renegotiation. This fund is not one of the most popular and so the size of the assets in this alternative option is much smaller than the size of assets under the default arrangement. I don't think it would even help much as the charges are not particularly high, so the net of fees performance would not improve much.'

John says: 'I am getting a sense that we might need to recommend removing this fund from the options offered.'

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Decision point: Changing a fund

The sub-committee discuss the various options they have and the areas they need to consider before making a recommendation to the trustee board to change this fund. Which three of the following statements made during the conversation are correct?

1. As we don't have a similar fund to the one we are proposing to close we will need to carry out an appropriate selection process to select one.
2. If we move the existing assets, we should consider different methods of minimising out of market risk.
3. We can use an in-specie transfer so that we don't need to write to the members to inform them of the changes.
4. We must close this fund and transfer all of the existing assets to another.
5. We should check our scheme rules to see whether we need consent from the members to replace this fund.

Turn to the back for the answer.

Recommendations

George has checked the scheme rules and the trustees do not need consent from the members to change a fund. They continue to discuss their options for a while before agreeing to the recommendations below.

- Continue to monitor the default arrangement more closely
- Start discussions with the investment manager for the default arrangement to renegotiate the fees.

They will also set out the two options regarding the Global Equity Active Managed fund:

- Close the fund to new contributions only but write to the members invested in this fund to explain why they are making the changes and alert them to the performance
- Close the fund to new contributions and transfer all the existing assets as well. The report will explain the steps the trustees need to take to do this including how they might minimise out of market risk.

For both options the report will also set out the need for an appropriate selection process to replace the fund as there are no other similar funds available within the current range.

Rounding up

The report was presented at the next trustee meeting and was approved with the second option chosen for the transfer of existing assets as well as closing to new contributions. The trustee board will continue to govern the scheme in the best interests of the members and beneficiaries together with the relevant legislative requirements.

Glossary

Chair's statement

A document that must be produced by certain DC schemes and DC sections of hybrid schemes that sets out how specific legislative governance standards have been met (see the Occupational Pension Schemes (Charges and Governance) Regulations 2015). It must also contain the statement of investment principles for the default arrangement.

The chair's statement must be signed by the chair of trustees on behalf of the trustees and be included in the scheme's annual report.

Trustees must declare whether they have complied with the requirement to produce this statement when they complete their scheme return. Trustees that have not complied with the requirement to produce the chair's statement will be fined between £500 and £2000.

Statement of investment principles (SIP)

A written statement of the principles governing decisions about investments for an occupational pension scheme, which trustees are required to prepare and maintain. When preparing the SIP, trustees must have regard to advice from a suitably qualified person, and consult with the employer.

For default arrangements, trustees must prepare a separate written statement of investment principles governing decisions about investments for the purposes of any default arrangement, covering the aims and objectives in respect of the investments, the investment policies in respect of the default arrangement, and an explanation of how the aims and objectives and the policies are intended to ensure that the assets are invested in the best interests of members and beneficiaries.

Decision point answers

Charges and value for members

Options 2 and 3 are correct. The definition of dual pricing is correct and the cost incurred by members is often called the 'bid-offer spread'. It is also correct that if the scheme offered the range of funds via a platform that there may be additional charges, normally passed on to the member, which may be included in the annual management charge (AMC) or listed separately.

It is not true that white-labelled funds will always be lower than equivalent investment manager branded funds; in some arrangements there will be an additional cost.

Finally, costs and investment charges are usually lower for the equivalent passively managed funds compared to actively managed.

Changing a fund

Options one, two and five are correct. The trustees will have two options: to transfer all of the existing assets to a new fund, or to leave the existing assets where they are but close the fund to new contributions. In any event, the trustees should check their scheme rules to see whether they need the members consent to change a fund.

Transferring the existing assets will usually involve a bulk transfer which will require careful planning and consideration given to minimising out of market risk for the members.

An in-specie transfer is one of several ways to minimise out of market risk, but it has no impact on whether trustees need to communicate with members.

You have now completed this scenario which is the last in the series for this module. You should now go online to take the assessment and test your knowledge. If you pass the assessment your development record will be updated with your achievement.

We would recommend you complete the Check your scheme worksheet for this module which can be downloaded from the Resources section of the Trustee toolkit. You may need to look at your scheme documents, talk to your colleagues or assess your scheme to help embed the learning from this module.