



**UNPACKING VALUE FOR MONEY CONCEPT IN  
RETIREMENT FUNDS**



**PENSION LAWYERS ASSOCIATION VIRTUAL CONFERENCE**

**Monday, 9<sup>th</sup> May, 2022**

**Speakers: Belinda Sullivan, Philip Bennett and Jonathan Mort**



## AGENDA

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National Treasury Proposals (Belinda)

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UK Perspective (Philip)

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Commentary from SA Aspect (Jonathan)

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Discussion

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**NATIONAL TREASURY PROPOSALS  
BELINDA SULLIVAN**



## National Treasury Proposal

- Referred to in “Governance of umbrella funds” paper on 14.12.2021  
([http://www.treasury.gov.za/comm\\_media/press/2021/2021121401%20Commercial%20Umbrella%20Funds.pdf](http://www.treasury.gov.za/comm_media/press/2021/2021121401%20Commercial%20Umbrella%20Funds.pdf))
- Background is the consolidation of occupational funds into umbrella funds
- Focus is on commercial umbrella funds (type A)
- Considerations type A vs type B and the perceived issues
- Type B funds : member representation on the board of trustees – perception
  - Better governance
  - Better outcomes for members
  - What is the evidence in support of this relative to type A umbrella funds
  - Barriers highlighted exist in many type B umbrellas
- Context of reform should limited to type A?



## National Treasury Proposal

- The concerns raised in respect of commercial umbrella funds (type A) (with main rules and special rules):-
  - Weak governance (service providers linked to sponsor, board is not truly independent)
  - Complex and opaque charges
    - Voluntary membership and adoption of ASISA standards
  - Barriers to entry and switching funds
    - While cost efficiencies and effort are highlighted here
    - What are other legislative issues that impact the decisions to move funds:
      - Annuitisation: impact of members age 55 years and older in provident funds
      - Section 14s

Suggests look at UK proposal of value of money to cure these defects



## National Treasury Proposal (cont)

What are NT's thoughts to resolve the problem of commercial type A umbrella funds?

- Looking to enhance the governance structure (see GN 4/2018)
- Chilean auction system to reduce costs
- More transparency around costs
- Establishment of Independent Governance Committees (IGCs) per UK model, specifically to assess value for money for members

This last point is what this session is about



## National Treasury Proposal (cont)

What does the paper say about introduction of IGCs into commercial umbrella space?

- Adaptation of Mancom, with statutory recognition
- Do not say how will be constituted, but implies as per Mancom (half employer, half member)
- Would have the following functions:-
  - Conduct ongoing value for money exercise, per prescribed criteria
  - Umbrella funds that don't comply will be closed
  - Assist fund with info on member data
  - Ensure contributions are paid
  - Process death benefits
  - Communicate to members
  - Recommend change to benefit structures



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**THE UK PERSPECTIVE  
PHILIP BENNETT**





## PART I: SOME BACKGROUND

What are we talking about today

1. Some background
2. Authorisation regime for UK master trusts: Overview
3. Restrictions on charges
4. Governance requirements
5. Prohibition on ties
6. Annual governance report to members



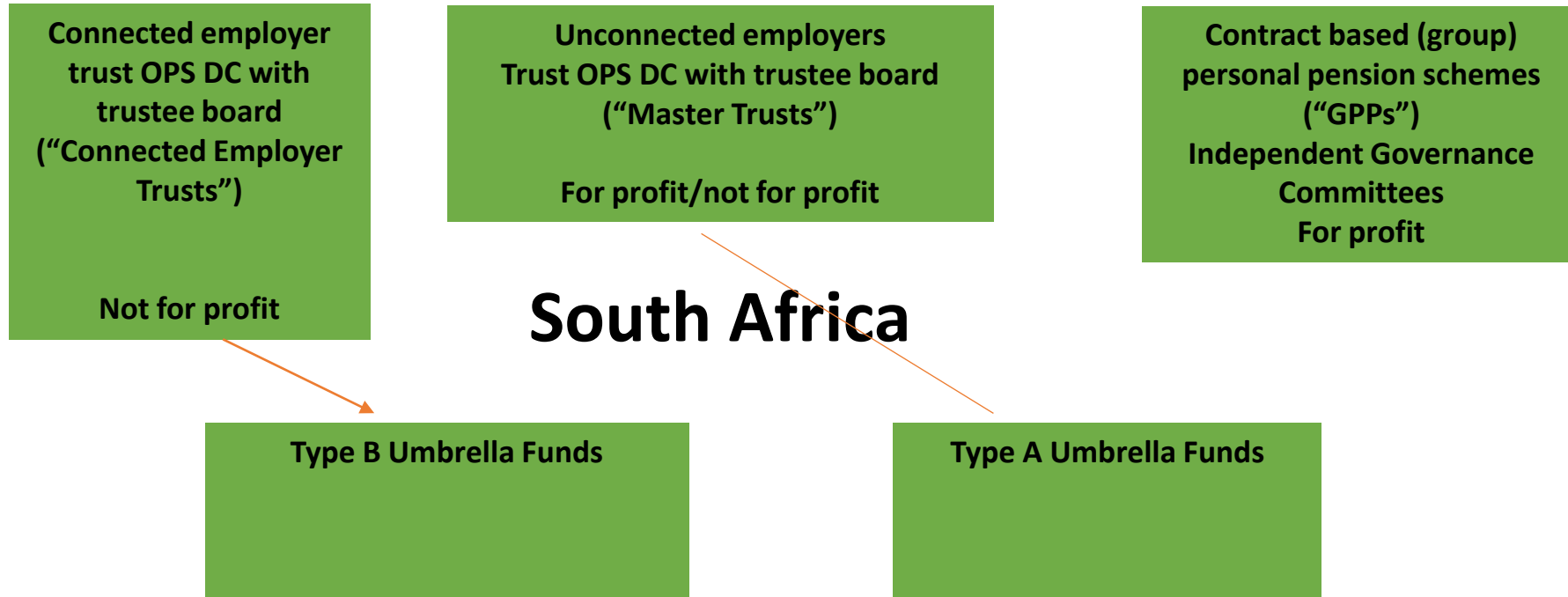
## Some background

- Impact of auto-enrolment on number of members in DC trust based occupational pension schemes (“**OPS**”). Active DC members *“rose from a low point of 0.9 million active members in 2011 to 10.6 million members in 2019.”*
- Tax incentives for retirement savings in DC scheme
- Employer sponsored DC schemes
- Industry sector DC schemes and the National Employment Savings Trust (“**NEST**”)
- Commercial providers and “master trusts”
- Pressure to consolidate and economies of scale



## Taxonomy

## UK





## Exceptions

- DB schemes/ DB Sections
- Single member schemes,
- Certain schemes with fewer than 12 members
- Certain executive pension schemes



## Default arrangements and the charge cap

### What is a default arrangement?

- DC scheme set up under trust (whether Connected Employer Trust or Master Trust) which qualifies to be used for auto-enrolment
- Contribution to member's retirement account automatically allocated to "default investment option" (96% of all DC members), **OR**
- At least 80% of contributing members have chosen to have their retirement accounts invested in this investment option (excludes AVCs)

**Note:** Relevant to charge cap (more later).



## PART II: AUTHORISATION REGIME FOR UK MASTER TRUSTS: OVERVIEW

### Authorisation regime for UK master trusts: overview

- UK Master Trusts correspond to SA Type A Umbrella Funds
- Require authorisation by the UK Pensions Regulator in order to receive contributions (NB Connected Employer Trusts do not require that authorisation)
- Rigorous process (in PSA 2017) including:
  - Trustee board members (and others) to be “fit and proper persons” and majority “non-affiliated” - see later
  - Requirement for “scheme funder” to cover running costs if admin charges insufficient unless exception applies
  - Rigorous assessment of IT systems and processes
  - Rigorous assessment of administration and investment system and processes
  - Assessment of adequacy of financial resources to operate master trusts successfully- Master Trust must be financially sustainable
  - Continuity plan if Master Trust can no longer continue



## PART III: RESTRICTIONS ON CHARGES

### Restrictions on charges payable from default arrangement

- Applies only to default arrangement **BUT** in both Master Trusts and Connected Employer Trusts
- What charges are restricted?
- Everything except:
  - Transaction costs (e.g. buying or selling investments)
  - Property holding and maintenance costs (where direct investment in property)
  - Costs of providing death benefits (e.g. insured lump sums)
  - Costs of complying with a court order (including pension sharing on divorce)
  - Winding up of scheme costs



## Does this apply for the other arrangements in Connected Employer Trusts and Master Trusts?

- No – only the default arrangement
- But see later for:
  - charging for services or advice provided directly to the member (excluding “core services” ),
  - prohibition on charges to reimburse directly or indirectly a person who provides services to the employer or to the scheme (with certain permitted exceptions)
  - value for money,





## What is the charge cap on the default arrangement?

- Only 2 options allowed
  - **Single percentage charge cap** limited to at **0.75%** a year of default arrangement assets, or
  - **Combination charge cap** limited to:
    - a) A maximum contribution charge, plus
    - b) A maximum percentage of the default arrangement assets
- Combination charge cap options:
  - **percentage of contributions** plus percentage of default assets, or
  - **flat amount** per member per year plus a percentage of default assets



## Anti avoidance and related restrictions

- Prohibition on payment of introducer fees/commission out of trust assets unless exception applies (basically independent unlinked to membership agreement)
- Other restrictions on payments out of trust assets to financial or other service provider unless independent separate agreement in places (and does not cause charge to be exceeded)
- Ban on penalties/ differential charging for stopping contributions or transferring out
- Ban on discrimination between contributing members and non-contributing members on charging



## PART IV: GOVERNANCE REQUIREMENTS

### Governance requirements: Trustee board composition

- Requirement to have:
  - At least one third of trustee board composed of member nominated directors
- Unless:
  - All directors are independent, or
  - Another exception applies
- Additional requirements for master trust:
  - Requirement for at least a majority of directors on trustee board to be **non-affiliated** (next slide) directors of the trustee company, and
  - Must satisfy Pensions Regulator fit and proper person requirements



## Non-affiliated

- **Non-affiliated:** **independent** of any one providing admin, investment, advisory or other services to in respect of Master Trust
- **Independence assessment** includes:
  - 5 year look back period for directors, employees and partners
  - payments and other benefits from service provider affect whether non-affiliated test is met
  - other conflicts of interest affect whether non-affiliated test is met
  - 5 year term limits (and anti avoidance rules - to cover stepping down and then immediate reappointment)



## Knowledge and understanding requirements

- Trustee directors to demonstrate knowledge and understanding required by legislation in relation to the pension fund (and see reporting obligation – later)



## UK governance requirements for GPPs : Independent Governance Committees

- Legal form- FCA Rules require GPP provider (usually an insurance company) to set up IGC which meets FCA Rule requirement – IGC’s constitution (ie source of IGC’s powers) written by GPP provider subject to FCA Rules. Contract between each member of IGC and GPP provider as to scope of duties of IGC member
- GPP provides resources to IGC (so independent advice constrained by resources)
- IGC has to report annually to GPP provider on comparable matters to trustee board
- IGC owes a contract created fiduciary like duty to act in best interests of members under agreement with GPP provider- no contract with members and no direct fiduciary relationship. Possible duty of care in tort (negligence) to members and employers?
- No power to hire or fire GPP provider. But if considers GPP not responsive to IGC value for money findings can report to FCA who can then review whether GPP provider is treating its members fairly in accordance with FCA Rules (and publicise to employers/members)
- Example IGC terms of reference <https://www.aviva.co.uk/adviser/documents/view/sp03345c.pdf>



## **PART V: PROHIBITION ON TIES**

### **Prohibition on ties**

- Any requirement in trust deed of a Connected Employer Trust or a Master Trust only to invest in products or services of a particular financial services provider (or to choose from a restricted range of providers) is void
- Overrides any provisions in the trust deed



## PART VI: UK ANNUAL GOVERNANCE REPORT TO MEMBERS

### Annual governance report to members

- Requirement for Connected Employer Trusts and Master Trusts to produce a Chair's annual governance statement to cover:
  - Review of default arrangement
  - Confirmation that contributions have been received on time and invested on time and payments to members have been made on time
  - Disclosure of costs and charges borne by members' retirement accounts
  - Assessment of value for money of those charges and costs for members (see later slide for additional requirements for schemes with assets < £100 million)
- Similar for IGC





## Annual governance report to members (cont'd)

- Requirement for Connected Employer Trusts and Master Trusts to produce a Chair's annual governance statement to cover (cont'd)
  - How the trustee board has met the statutory knowledge and understanding requirements applicable to them and, how, together with advice from their advisers, enables them properly to exercise their functions
  - For Master Trusts how the requirement to have the majority of the trustee board **non affiliated** have been met



## How is value for money assessed?

- Trade off between cost and services
- To what extent is investment return on retirement accounts important?
- To what extent are retirement income outturns important?



## How is value for money assessed in the UK- pressure to consolidate for <£100 million schemes

- Must assess (from October 2021), for schemes with assets of < £100 million, charges and investment return performance information relative to 3 comparison schemes (large OPS at least £100 million assets or a GPP)
- Must assess for such schemes whether governance and administration criteria are met which include:
  - Quality of records and timeliness of processing transactions
  - Quality of investment governance and appropriateness of default investment strategy
  - Skills and knowledge of trustee board and conflict of interest management
  - Effectiveness of member communications



## ADDITIONAL RESOURCES

- **DWP charge cap guidance:**

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1045257/charge-cap-guidance.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1045257/charge-cap-guidance.pdf)

- **Code of Practice No. 13 (Governments and administration of occupational trust-based schemes providing money purchase benefits):**

<https://www.thepensionsregulator.gov.uk/en/document-library/codes-of-practice/code-13-governance-and-administration-of-occupational-trust-based-schemes-providing-money-purchase>

- **Code of Practice No. 15 (Authorisation and supervision of master trusts):**

<https://www.thepensionsregulator.gov.uk/en/document-library/codes-of-practice/code-15-authorisation-and-supervision-of-master-trusts#0ad5b4254da547aeb4850c9dfeaeb017>



## ADDITIONAL RESOURCES ON UK (cont)

- FCA Final Rules for IGCs (February 2015) and response to consultation: <https://www.fca.org.uk/publication/policy/ps15-03.pdf> (NB these have been amended but include analysis of legal relationship of IGC to GPP members)
- FCA Final Rules for IGCs and assessment of value for money (October 2021): <https://www.fca.org.uk/publication/policy/ps21-12.pdf>
- Joint tPR/FCA discussion paper on assessing value for money (September 2021) <https://www.thepensionsregulator.gov.uk/en/document-library/consultations/value-for-money-discussion-paper>



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**COMMENTARY FROM SA ASPECT  
JONATHAN MORT**



## Comments from a SA Perspective

- What do members want-
  - Retirement savings are safe
  - Earning a good net return
  - Are available when they need it
- The paper is about governance so useful to look at the purposes of good governance:
  1. Provide the benefits promised
  2. Ensure benefits are optimal within an appropriate level of risk
  3. Ensure the costs are reasonable and transparent
  4. Ensure that how benefits are managed and provided can be trusted by stakeholders.
- Value for money is about points 2 and 3 (optimal benefits, reasonable and transparent costs)
- Ultimately, embedding of TCF



## Comments from a SA Perspective (cont)

- The key is the establishment of IGCs to establish value for money have the functions NT proposes
- But NT has not understood properly how Mancoms operate –
  - Have no delegated responsibility because of s 7D(2) (board is liable for delegated responsibilities)
  - So serve an advisory function
  - However, they do sometimes have a delegated authority on behalf of employer (especially iro default investment portfolio, insured risk benefits)
  - Proposed IGCs do not carry out the functions of Mancoms





## Comments from a SA Perspective (cont)

- The problems with NT's concept of IGCs-
  - The UK IGC is not analogous because there it does not operate where there is a fiduciary obligation (in UK it is in contract based arrangements, not trust arrangements)
  - NT's IGC clearly will have a fiduciary obligation – not clear how this will be split between trustees and IGC
  - Begs the issue of how IGC will have the skills to carry out its functions, will need service provider support which will entail expense
  - Will not have power to interfere in appointment of service providers to the fund which is the problem
  - Appears to be based on splitting current responsibilities of board between board and IGC
  - Not mention of value for money exercise being affected by poor delivery even if low costs and good returns.



## Comments from a SA Perspective (cont)

- Suggest another way to look at this is to require IGCs to assess the governance of the board with specific reference to costs, benefit structure, service providers and to report to stakeholders (members, employers, FSCA, sponsor)
- IGC should be able to obtain information from board about the operation of the fund
- Discuss what teeth IGC should have in respect of operation of board
- Should have at least one independent member on IGC

# THANK YOU

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