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STARTING POINTS IN IMPLEMENTING AND OPERATING

DEFINED CONTRIBUTION SCHEMES

INTRODUCTION

Whilst this is an area in which developments are likely in the current year and beyond, this document aims to offer a basic framework to assist in the successful establishment and operation of, and drawing of benefits from, defined contribution schemes.

It is designed to be of assistance to scheme sponsors, in making design choices, in collaboration with human resource and pensions professionals. A successful scheme will most likely be one where the interaction of the employer, advisers, providers and investment managers will result in good outcomes for scheme members. This document is intended to support all those stakeholders in achieving this aim.

It is not intended for use by scheme members themselves and is probably not suitable for use by scheme sponsors without the collaboration of human resource and pension professionals, as already mentioned.

The document is not intended as a substitute for existing material addressing many of the matters covered here, produced by regulatory or consumer bodies or by providers of pension advice and services, which would include a number of SPC Members.

It is not the aim to set out legal obligations or to dictate best practice, but we intend to assist in meeting legal obligations and in achieving best practice.

We aim to work through the three main stages of a scheme (establishment, operation and decumulation), although some items are relevant to more than one stage and are therefore listed more than once.

The document is intended to be relevant to contract and trust based defined contribution schemes. Certain items in it will not need to be acted upon in respect of every scheme.

It does not aim to cover hybrid arrangements.

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STAGES	STARTING POINTS	COMMENTS
1. ESTABLISHMENT AND IMPLEMENTATION OF A NEW DEFINED CONTRIBUTION SCHEME **Scheme and Contribution Structure and Projected Outcomes** The Employer and the Adviser may wish to start with some benchmarking to answer two basic questions: (a) what levels of contribution are appropriate and (b) what type of scheme is appropriate, in order to meet key objectives for the recruitment and retention of staff. The design of a new DC scheme may also arise from a decision to cease – in one form or another – DB provision. Decisions as to whether to operate a trust based, or contract based scheme are likely to be made early in the decision making process. This process might lead to asking some or all of the questions opposite.	• Has the market been surveyed for competitiveness of the range of employer and employee contribution rates? • Does the scheme replace an existing one (whether defined benefit or defined contribution)? • If so, does account need to be taken of (a) existing benefits or contribution rates and (b) members' expectations of what they can and should pay (see below)? • Does the scheme aim for a particular pension outcome? • Do wider considerations for the employer (for example as part of an international group) need to be taken into account? • Should the scheme integrate with other employee benefits and, if so, how? • Are there any other company benefits with which it might integrate (e.g. Flexible Benefits) or compete (e.g. share save schemes)? • Are any special arrangements required for high earners? • What can the employer afford by way of	Market benchmarking might look at sector provision (e.g. Engineering, media etc.) or at the local employment market. Determining the "market" against which benefits which will be set is key. The employer may wish to consider age related, service related contribution structures and matching ratios. Consideration may need to be given to "legacy" matters – prior acquisitions, previous benefit promises and A Day protections. A scheme may need different sections and contribution rates to deal with these matters. For example, are previous (DB) benefits trying to be "replicated"; is a particular income replacement target, integrated with state benefits, being sought? General Comment: Note that any decision to contract out of the State Second Pension through a contracted-out money purchase ("COMP") trust-based scheme will be short-lived as this will no longer be possible from April 2012.

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	establishment costs and continuing contributions, i.e. has a budget for pensions and/or wider employee benefits been established? • Is the scheme to operate on a salary sacrifice basis? • At what level will the core employee contribution be set? • What level of contributions can employees afford? • Will the contribution structure be flat-rate, age, service or seniority related? • Is it intended to include an automatic annual increase in employee contributions? • Who will be able to join the scheme (if the employer has other, defined benefit, arrangements) and has account been taken of automatic enrolment from 2012? • Is it intended that the scheme will operate in conjunction with NEST or is it intended to become the auto enrolment vehicle for the employer duties? • What will be the arrangements for scheme leavers? For trust-based schemes, full or minimum vested rights? For contract-based schemes, should the charging structure/ options be different from those for active members?	

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Launching the Scheme **Members' Expectations of Outcome at Retirement/Tailoring of Proposition** The launch of the scheme is hugely important in setting the expectations of members, capturing engagement early and building a continuous communications programme. Communications need careful consideration and the questions opposite are intended to offer guidance in determining the most appropriate programme.	• How homogeneous is the employee base (i.e. will expectations of retirement outcomes vary significantly from shop floor to board room and what effect will this have on communications)? • Are employees familiar with the concept of income replacement ratio? • Do members understand the overall elements of retirement provision, i.e. other private arrangements and state benefits, within which the scheme sits? • Are employees capable of understanding sensitivities of outcome to falls in yield, whether due to lack of return, the impact of expenses or inflation, as well as the concepts of capital conversion and annuity risk? • If employees' expectations are negligible/unknown, should they be established and, if so, how? • Are employees encouraged to plan financially by reference to their dependants? • What support is to be offered to members to evaluate investment options?	How will members become engaged in understanding these issues; the sensitivities and the benefits from increasing their own contributions?

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	• Will initial expectations, once established, be regularly reviewed with the employees, by the employer or an independent adviser and, if so, how? • Depending on the structure of the scheme, which party has taken responsibility for communication, education and member engagement (employer, trustees, governance committee, adviser, provider)? [See communications below]. • Will investment choice be offered to members or determined at trustee/sponsor level?	
Choosing Providers for successful Scheme operation Depending on the structure of the Scheme (trust or contract) and the intention to operate on a bundled or unbundled basis (i.e. with or without other administration/management services as part of the same product), a number of Providers may need to be appointed. We highlight some considerations in the selection of providers in the questions opposite.	• Are there existing systems/service providers which might be used to achieve economies of scale (this might influence the legal structure of the scheme)? • Does the employer have confidence in existing insurers and investment managers for other risk products/existing pension schemes? • Is there a need for a selection process to find a new provider/confirm existing provider? • What due diligence will be carried out on potential providers' (a) fund performance, (b) charging structure, (c) administration service levels, (d) financial strength and reputation/ brand and (e) communication materials and	The background to the scheme might lead to a number of providers already being in place. Expertise in DB, for example, is not always a precursor to DC, and so due diligence should be considered even for existing advisers.

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	media (e.g. internet based)? • What approach is going to be taken to investment funds and member options? • To what extent is the membership likely to actively take up and select fund options? • How many default choices do potential providers offer? E.g. is the default fund to be set up on a lifestyle or target date funding basis? • Can the default fund(s) be tailored to the membership profile? • Who manages the default fund(s), i.e. are all managed in house or are any external managers involved? • What special considerations in relation to the membership and its profile might be relevant to the construction of the default fund? • Will fund options be intelligible to proposed members? • Will allowance for particular types of investment fund be made (e.g. ethical or religious funds)? • Has the employer considered a service level agreement with the scheme provider (or is there already one through a separate arrangement)?	 In a trust-based scheme these responsibilities rest with the trustees; for a contract-based scheme the employer must determine this or leave it to the provider.

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	• What e-comm facilities are offered in terms of administration (on-line billing etc.) and member access to manage their accounts on-line?	
Scheme Governance Scheme governance will in part be driven by the underlying scheme structure (trust or contract), but the Pensions Regulator will expect roles and responsibilities and levels of governance to be of high standards under either model.	• Have the advantages and disadvantages of contract and trust models been evaluated thoroughly? • What are the members' expectations and needs for governance; how should they be represented in governance structures? • What resources will the employer have to provide support for scheme governance, both in terms of people and time? • What management information for those charged with governance responsibilities will be provided and what processes will be in place to review and take action upon it?	This is especially relevant to contract based schemes where there are no member-nominated trustees. Terms of reference should be established and education provided. For example, details of the take up rates and levels of member contributions form part of the management information being developed.
Communications Communication will be an important feature, not just of a scheme launch, but ongoing, so many of the questions here are also relevant to the Scheme Operation section. The establishment of the DC Scheme might involve formal consultation in relation to changes to benefits. Responsibilities for	• Who will write (and check) initial communications materials to ensure that they are in keeping with the employer's house style and are consistent with communications on other employee benefits? • How has the fundamental message of members assuming responsibility for	

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member communication should be established and a formal communication programme might be developed.	investment decisions been communicated to employees (especially on a change from DB)? • Has adequate time for drafting and producing communications been allowed? • Is the communication programme largely online, paper based or a mixture of media? • Does the joining process fully engage members? • What support will be offered to members during launch programme (seminars, financial advice, written materials only, financial modellers and other planning tools)? • Will there need to be a "road show" or other group meetings at launch? If so, who needs to attend and lead presentations? • Who will respond to member queries, e.g. on member elections of fund choices or nominations of beneficiaries, change of retirement date?	The mix for member communication will be important, comprising paper, voice and online channels.

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2. SCHEME OPERATION **Administration** This section seeks to highlight the key aspects of administration. The relationships between the employer and its processes, as well as focus on the role of the Scheme Administrator, are important. The Pensions Regulator will, for instance, be keen to ensure the quality of data is high and data standards form part of scheme administration. As a general observation, standards of scheme operation and administration should be similar irrespective of the structure used for the scheme.	• Has the sponsor ensured that the payroll department pays contributions on time? • Are new hires notified to whoever is responsible for new member communications? • What are the target times for acting on member instructions? • Is administration subject to a service level agreement? • Do reports on administration performance cover the scheme only, or all similar arrangements with the provider? • Are any aspects of scheme administration off shored? If so, have any potential data protection concerns been addressed (e.g. data sent outside the European Economic Area)? • Is there sufficient management information to facilitate proper understanding of how the scheme is operating? How will such information be used? • Does the scheme take steps to ensure that deferred members continue to be well served? For instance, are they included when reminders to check fund choices are sent out	Some training for payroll may be necessary. It would be normal for service levels to contain clear timeframes (e.g. target dates plus an allowance) as a service level agreement for contribution investment and switches. Part of the governance arrangements should include what action is taken when service levels reach points of failure. This might extend to deferred members having the same access to information (website access), being sent information at the same time as

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	and are changes of address regularly checked? • Do tax relief deductions work properly? • What on-line facilities are offered, both for administration (e.g. for billing to the sponsor/trustee) and member access for account management?	actives.
Fund Performance/Monitoring Investment options for DC schemes are a huge subject and this section seeks to highlight some of the issues that will need to be addressed. At the outset, governance will need to establish the range of fund options, the structure of the default fund(s) and the overall monitoring of these arrangements.	• How frequently is performance, including volatility, assessed; where will responsibility lie for changes to investment options and funds? • Have appropriate benchmarks been chosen? • Do the underlying investments match expectations of what the fund should hold, e.g. "cash"-type instruments or "white labelled" (i.e. employer branded) funds? • Can members clearly understand how to switch funds and when they should switch (e.g. if not in a lifestyle fund or not done automatically)? • How will members be encouraged to think about their investments in relation to their retirement date and range of annuity options? • Do scheme renewal processes encourage members to review key fund choice decisions?	

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Communications Members should be provided with performance information in relation to their funds, but these questions are designed to prompt the employer/trustees to take a more active role in ensuring such communications are not merely passively forwarded on to scheme members.	• What arrangements are in place to act on underperformance? • What mechanisms and budgets are there for regular (e.g. annual) review of communication materials relating to investment? • Are materials tested on employees for user friendliness? • What tools might be available for members to understand their attitude to risk? • Will these include tools to enable members to understand the respective risks of investment options? • Are trigger points used for communicating with members, especially if invested in default options?	

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3. AT RETIREMENT **Members' understanding of Annuity Products and preparation for retirement** It will be important, as part of the overall communication and member education programme, that a good understanding of the "at retirement" process is achieved. This will enable members to think, not only about the value of their investments, but also their buying power in terms of annuity. Building an understanding about different types of annuity will be important.	• Are there procedures to follow up with members on standard disclosure requirements (due 6 months ahead of the member's normal retirement age)? • Who is responsible for communicating with members in good time before retirement (e.g. an employee benefit consultant or a provider)? • Who is responsible for arranging quotations from providers? • Will members be given access to an annuity intermediary prior to retirement? • Will the scheme be offering or promoting draw down as a retirement option? • Who will pay for any individual advice on retirement choices? Where relevant, are members encouraged to use an independent financial adviser or employee benefit consultant? • Is any assessment made of cases where a standard lifetime annuity would not be the best option? • Are members expressly warned about the effect on their dependants of retirement choices?	NB. The 6 month period refers to trust-based requirements. For contract-based arrangements, the provider must contact the member. NB. For contract-based schemes different time limits apply depending on whether the member had protected rights, but 4 months is the minimum period for contacting the member pre-retirement. Members should be given the opportunity to understand the value of the open market option, the difference between normal and enhanced annuity rates.

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Administration	• Do members understand the impact of inflation and longevity on their decisions at retirement? • What weight is given in investment strategy leading up to retirement to preserving accumulated funds? • How flexible are scheme rules in allowing members more than one opportunity to convert accumulated funds into retirement income? • Is there a service level agreement covering processes at the point of retirement? • How does this ensure that annuity quotations do not expire during the administration process? • What arrangements are in place for tracing deferred members before retirement date (for trust-based schemes)? • What processes are there for dealing with payment of small sums? • Does the employer monitor the members' satisfaction with annuity providers after retirement? • What arrangements are there to ensure that retirement benefits are paid on time?	If the scheme has members other than in lifestyle or target date funds, what support and reminders are offered to members to assist with correct investment decisions?

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