

The Trustee toolkit downloadable

How a DC scheme works 2014

Scenario two

In this scenario you and your fellow trustees continue to discuss the DC scheme and in particular the second complaint from Mr Pegg which focuses on the scheme charges and his annuity quote.

As you work through this scenario you will be tested on your knowledge at decision points. Here you will have the option to work through a related technical tutorial before returning to the scenario or you can skip the tutorial. You can always work through the tutorial separately later if you would prefer. This scenario includes two tutorials:

- ▶ Value for members and charges
- ▶ Decisions at pension age

Glossary

A detailed glossary of technical terms can be downloaded from the Resources tab when you log in at www.trusteetoolkit.com

Mr Pegg's complaint

Charlotte introduces the next item on the agenda, a complaint from Mr Pegg.



Charlotte says: “We’ve received a letter from Arthur Pegg, who joined the scheme ten years ago and is just about to retire. Arthur has been paying six percent and, as most of you know, our employer matches members’ contributions up to a maximum of 6%. All these contributions (12% pa) have given Arthur an accumulated pension pot of £45,000. In the first of his complaints in this letter, he says he was ‘shocked’ to see how much had come out of his pension in charges. He says if he’d been told about the charges he wouldn’t have joined the scheme. His second complaint relates to the annuity quote from our usual provider. He was expecting a much bigger income than the quote suggested, and is demanding an explanation.”



Decision point: Charges

The trustees begin by looking at the charges for the DC scheme. As well as the costs of administering the scheme, there are charges for managing the investments. Can you match the descriptions to the correct charge?

Charges: Portfolio turnover rate (PTR), annual management charge (AMC), total expense ratio (TER)

1. A measure of how frequently an investment manager changes the underlying investments of a fund during a defined period
2. Covers the costs of running the fund, stamp duty on the purchase of shares is not usually covered within this charge
3. Worked out historically and includes the AMC, legal and audit costs, custodial fees and investment administration fees but not transaction costs

Answers at the back



Need help with this question? Read the Tutorial ‘Value for members and charges’

The annuity quote

The trustees move on to discuss the annuity quote Mr Pegg received before deciding what to do next. John asks: “How much was the quote for?”

George replies: “£1,800 per annum, increasing each year.”

Rodney comments: “Even if it is increasing each year, that doesn’t sound like a lot for a pot of that size.”

Alicia says: “From this paperwork it also looks like this is a single life annuity but it has a five year guarantee period. I wonder whether the information we provide to members about how they can take their pension benefits is sufficient. Perhaps Mr Pegg could have looked at alternatives if he was better informed?”



Decision point: Taking an income

The trustees are discussing Arthur Pegg’s complaint and, in general, the options members have when they access their pension benefits. Look at the statements below made during the conversation. Which three of the statements made are correct?

1. A member can take their entire pension fund as a cash lump sum, some of which will be subject to tax
2. Extending an annuity guarantee period from five to 10 years increases the starting level of a pension
3. Flexi-access drawdown is an option for members with a secure income from other sources which meets a minimum level
4. Members have a right to use the open market option
5. Trustees can explain the options that may be available to members but must tell members about the government’s ‘Pension Wise’ guidance service

Answers at the back



Need help with this question? Read the Tutorial ‘Decisions at pension age’

Next steps

Charlotte brings the meeting back to order so they can make a decision about what to do with the complaints. She says: “I suggest we raise a second issue with the administrators and ask them to provide us with relevant information so that we can be sure that the correct charges have been deducted from Mr Pegg’s pension pot. Are we all in agreement? George, can you contact the administrator and take them through these issues? We’ll need to check whether he is invested in the default arrangement and whether the legislative charge restrictions apply to his fund.

Regarding Mr Pegg’s complaint about the quote, we’ll reply to him to remind him of the options available to him and tell him about the government’s ‘Pension wise’ guidance service. We can also suggest he considers taking independent financial advice on what would be the best option for him.

We’re also going to look at the communications in time for the next meeting. It is important that we make sure we clearly communicate member options and information about how they can get help in choosing the most appropriate option for them, ensuring we are compliant with our legal obligations.”

Rounding up

The trustees continue to assess other aspects of the scheme against legislative governance standards and other features important in ensuring members receive good outcomes from the scheme, identifying areas of concern for further investigation.

Now that you have completed this scenario we would recommend that you begin to work through the ‘Check your scheme’ worksheet for this module.

Answers

Decision point: Charges

The correct answers are: 1 = PTR, 2 = AMC, 3 = TER.

The PTR and TER are measures which can help trustees understand the wider impact of charges on a member's pension pot. The PTR can give an indication of what the transaction costs in an investment fund are likely to be. An investment fund with a higher 'turnover' is likely to incur more transaction costs.

The TER is worked out historically and can include a wider range of charges such as the AMC, legal and audit costs, custodial fees and investment admin fees but not transaction costs. It is usually expressed as a percentage of the fund (eg 0.3%) and goes to the investment manager to cover the costs of running the fund. It does not usually include stamp duty on the purchase of shares or stockbroking commissions for buying and selling investments.

Decision point: Taking an income

The correct statements are the first, fourth and fifth.

Flexi-access drawdown is an option for all members of DC schemes, as long as they are over the minimum pension age. Extending an annuity guarantee period is likely to reduce the starting level of the pension, not increase it.