Independent schools briefing, Quarter 3 2021
Considerations for a Defined Contribution scheme

Not all Defined Contribution (DC) pension schemes are the same. In this briefing we explain the different types of DC schemes available to schools. We also look at the possibility of schools using a single scheme for both teaching and support staff, taking a more holistic approach to provision.

This briefing aims to provide a useful overview of the main types of DC schemes available and how their features can be best aligned to meet the requirements of schools and their staff. For a more detailed overview covering replacement options for the Teacher's Pension Scheme, please refer to our **Q3 2020 briefing**.

Comparing different types of scheme

DC arrangements are established as either trust-based or contract-based schemes.

The basis on which any new scheme will operate is particularly important if a school wishes to look at harmonising the arrangements offered as part of a wider exercise, i.e. one that will incorporate existing arrangement(s) for support staff.

Across each scheme type, the provider generally recovers costs through an annual management charge (AMC) which is applied to the total funds under management. Since the AMC is deducted from the accumulated investments, it is the members, rather than the employer, who meet the cost.

Trust-based schemes

If a scheme is trust-based, then it will either be a single employer 'own rules' trust or a multi-employer master trust.

Occupational pension scheme – single employer trust

An occupational pension scheme is set up under trust, governed by a set of rules, and has a board of trustees who run the scheme. The trustees are responsible for looking after members' benefits (including deferred members and potentially pensioners), and it is this level of governance that is both the main attraction and the chief disadvantage of a trust-based approach.

The scheme can be 'bundled', whereby investment and administration services are carried out by the same organisation (typically an insurance company), or unbundled, where those services are carried out by a combination of service providers.

Initial set-up costs for this type of arrangement can be significant due to the requirement to establish the trust deed and rules, register with HMRC, prepare communication material and appoint advisers. This can also be very time-consuming, so a long lead-time is required if this type of arrangement is to be used.

Furthermore, under a trust-based DC arrangement, considerable effort and expense will be incurred in looking after benefits for individuals who have stopped working for the sponsoring employer. It is primarily because of these costs that few employers would now consider setting up a new 'own rules' trust-based DC arrangement for their employees.

Occupational pension scheme – multi-employer trust

Often called a 'master trust' arrangement, such an approach reduces running costs by achieving economies of scale, with set-up costs spread over a number of employers. Lead-times are reduced by using standard scheme documentation material.

Master trusts allow for formal governance to be undertaken by the trustees of the master trust in the same way as under an ‘own rules’ scheme. This can provide comfort to employers. Regulations governing master trusts give providers and employers more flexibility around the communications they issue.

Several organisations (such as NEST) have established master trust arrangements. These offer standard propositions as well as household names which offer client-specific terms and proposition flexibility. This means that there are effectively two markets for master trusts – a low-cost auto-enrolment solution built for the mass market, along with more ‘niche’ bespoke solutions.

The disadvantage of such a ‘packaged’ solution is that the standard policy applied by the central trustees may restrict flexibility.

Typically, the number of investment options available under a master trust is less than would be available under a contract-based scheme (see below), because the funds are overseen by the trustees and a closely-governed range of funds is more practical.

Contract-based schemes

Group personal pension (GPP)

Contract-based schemes are typically GPPs, although historically stakeholder schemes were also used. These are similar in nature and are simply a collection of individual policies under which each ‘member’ has a direct contractual relationship with the product provider (usually an insurance company).

In general, stakeholder schemes are no longer recommended, as they typically have higher costs than their GPP counterparts due to the legislation that enshrined them, and the range of investment options tends to be narrower. However, some of them – if they were established some time ago and have not been reviewed – do still exist.

The employer facilitates the ‘establishment’ of individual pension contracts for employees and the deduction of contributions from employees’ salaries, and pays them to the provider along with their own contributions. Through the buying power of the employer, better terms are available for employees than they could expect to obtain if they dealt with the product provider on an individual basis.

In addition, the fact that the employer has no direct contractual relationship with the provider means the employer’s role is focused on a small number of key areas, such as ensuring that:

1. employees are assessed for auto-enrolment and, where appropriate, auto-enrolled into the scheme
2. contributions are deducted and paid in a timely manner
3. effective communication about the scheme is provided
4. a suitable default investment option for employees is agreed as they are enrolled in the scheme
5. the provider remains appropriate for the pension scheme.

The number of investment funds available under a GPP can be vast; in some cases, hundreds of funds are available for members to choose from. A school can take investment advice, however, to implement a core fund range to help guide members.

Group self-invested personal pension (GSIPP)

A GSIPP arrangement is very similar to a GPP – the main difference being the investment options available and the level of investment choice available to members.

Typically, a GSIPP will have access to a much wider range of investment options than a GPP. Under a GPP, members are typically able to access 100–200 funds. A GSIPP gives members access to thousands of funds, including entire asset classes not available under a GPP.

The downside is that the increased investment freedom typically comes with increased cost, as some GSIPP providers will require the services of an Independent Financial Adviser (IFA).

Tax relief

Pension schemes are set up as either a *net pay* or *relief at source* arrangement. Each has its advantages and disadvantages in terms of how members access the tax relief on their contributions.

Net pay

Under a net pay arrangement, as used for the Teachers’ Pension Scheme, contributions are taken from gross pay and tax is paid on the salary after contributions have been deducted. In this way, tax relief is given upfront at the member’s marginal rate of tax.

Relief at source

Under a relief-at-source arrangement, the member's contributions are paid out of their net pay. The provider then reclaims tax at the basic rate on their behalf and adds it to the pension pot.

Generally, a net-pay arrangement benefits higher rate taxpayers, who obtain their full tax relief upfront. Under a relief-at-source arrangement, higher rate taxpayers only get basic rate tax relief upfront and will need to reclaim any additional entitlement through their self-assessment tax return or by requesting HMRC to adjust their tax code. Conversely, lower earners may benefit from a relief-at-source arrangement as they do not have to be a taxpayer to get the basic rate tax relief. Low earners may miss out on this extra top-up under a net pay arrangement.

Typically, occupational schemes such as master trusts operate on a net-pay basis, although a small number either operate on a relief-at-source basis or offer a choice. GPP arrangements operate on a relief-at-source basis.

Salary exchange and ongoing scheme governance

Irrespective of the tax basis on which a DC pension scheme operates, most schemes use salary exchange. This not only offers higher earners full tax relief upfront under a relief-at-source arrangement, but has the added advantage of both employees and employers being able to benefit from NI savings.

While the benefits of a correctly established salary exchange arrangement are manifold, it's important to implement it correctly. This will help to comply with HMRC's requirements while providing support to staff and communicating it effectively to them. In turn this can maximise take-up and reduce the number of enquiries.

Feature	Occupational (master trust)	Contract-based
Governance	■ Responsibility sits with an independent board of trustees ■ Dual governance is also available as an option, whereby the employer sets up its own oversight committee to sit alongside the trustees.	■ No need for a trustee board ■ No legal requirement for governance oversight, however it is considered best practice to have it in place ■ Oversight is required if the arrangement is to obtain the Pension Quality Mark.
Legal	■ Legal fees will be the responsibility of the master trust.	■ Any legal fees will be the responsibility of the provider.
Annual report and accounts	■ The same requirements apply as those of single employer schemes (as outlined on page one). However, costs will be the responsibility of the master trust.	■ There is no requirement to produce an annual report and accounts.
Employer and employee costs	■ Members typically pay an annual management charge on their funds to cover the cost of running the arrangement.	■ Members typically pay an annual management charge on their funds to cover the cost of running the arrangement.
Investment options	■ These typically provide access to a relatively small range of 'off the shelf' investment funds that the independent trustee body has selected.	■ These typically provide access to 100–200 funds, plus potentially to SIPP options ■ It's common to put in place a default fund, alternative lifestyle approaches and a core range of funds ■ The extent to which the employer has power to make future changes depends on how the terms of the contract, which will vary by provider.
Flexible retirement	■ Some master trusts may offer access to full pension flexibilities (although this is currently limited).	■ Potential for full flexibility (with the main providers now offering this as part of their 'core' product).
Communications	■ A website, online tools, literature and presentations are available. ■ Governed by trust law, with the trustees generally having full control over communications. Regulated by The Pension Regulator (TPR) ■ Not subject to the FCA's disclosure regulations, giving providers and employers more flexibility around communications.	■ A website, online tools, literature and presentations are available (the cost being met by members through the annual management charge) ■ Regulation by the Financial Conduct Authority (FCA) means that communications are more prescribed than with the other options.
Deferred members	■ An independent board of trustees retains compliance responsibility for build-up of deferred members ■ Once a member leaves, there may be restrictions on the contributions they can make in the future.	■ Once a member leaves employment, they manage their policy directly with the provider ■ The member retains the policy and can continue to contribute, as can any future employers.

Which option is most suitable for schools?

Both GPPs and master trusts have their own merits, and in practice, due to the bundled nature of the propositions, there is often little at face value to differentiate between the look and feel of the two types of arrangement. However, the subtle differences between each arrangement can become significant in terms of how they meet and satisfy the needs of the school and its staff.

Therefore, attention should be focused on the needs of the school and the staff for whom the scheme is to be used. So a solution-driven approach, rather than a prescriptive one, should be adopted.

Once those requirements have been confirmed and prioritised, then the work to research and secure the best solution can proceed, taking account of the relevant selection criteria. This helps ensure that the most suitable option is selected.

Where membership of the Teachers' Pension Scheme is being replaced by a DC arrangement, thought should also be given to the additional benefits that TPS provides, namely life cover and protection against loss of income through inability to work. While these cannot be addressed through any DC pension arrangement, there are separate insurance policies available to cover these benefits.

Governance and other considerations

As well as making an initial decision about the type of scheme to establish, we believe that it is best practice to establish an effective governance programme to keep the scheme competitive and fit for purpose, and to provide a high level of support to both the employer and its employees.

Good governance also gives employees access to the latest developments and online features in response to legislation changes and market developments.

Establishing a suitable governance programme will also assist with the development of an effective employee communication programme, helping employees to get the best out of their pension.

> While most schools will already have a DC pension scheme for their non-teaching support staff, that scheme may not have been reviewed for some time and may no longer represent good value for either the member or employer.
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> Implementing an appropriate governance programme will help to confirm the continued suitability of the scheme and the support programme available, and continue to give employer and employees a competitive and up-to-date proposition.

How First Actuarial can help

Having advised many schools on all the alternatives available, we can apply this experience during our consultation with you. We can help your school understand and define its pension strategy, as well as confirm and establish the degree of involvement and range of choices a school wishes to consider, along with the options they want to present to staff.

First Actuarial is a nationwide firm of pensions actuaries and consultants. We help independent schools with all their pensions issues.

We offer a unique blend of public service pensions expertise, consultancy and communication skills. We are also adept at running remote meetings, for both governors and staff.

To discuss any of the areas explored in this briefing, contact your usual First Actuarial consultant or any of the lead consultants in our Education team.

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We hope to see you at the forthcoming ISBA annual conference in November.