



## A practical guide to the governance of your DC plan

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# Introduction

Governance is very much a **hot topic** at present, with the Pensions Regulator issuing guidance on defined contribution (DC) plan governance and talk of **risk registers**, governance plans, **service level agreements** and other documents.

The phrase 'governance', however, can mean different things to different people and in relation to different pension schemes. For example, the level of governance required for a pension scheme can depend on the nature of the scheme (for example, whether it is trust based or contract based), the size of the scheme and the nature of the sponsoring employer. With so many factors to consider, it is often getting started that is the most difficult stage and to help you overcome this we have set out a practical framework for DC plan governance in this brochure – helping you minimise the risks and maximise the return from your DC plan.

## What is governance?

There are a number of definitions of 'governance' available, but in its simplest form it can be 'a set of processes to ensure a successful outcome' – for example, a profitable company, a prosperous country with law abiding citizens or a well run pension scheme with good levels of member engagement and a value-enhancing proposition.

In the context of DC plan governance, it is useful to split governance into two distinct components:

- **'operational'** governance – ensuring a scheme operationally functions effectively (for example, that contributions are paid and invested on time, benefits are

paid on time, and so on) and is run in accordance with the detailed legislative and regulatory requirements

- **'qualitative'** governance – ensuring that a scheme functions in the interest of pension scheme members, and seeks to improve the 'member experience' (for example, the fund range is appropriate, the investment managers are performing adequately, members are being communicated to effectively, and so on).

Operational governance is really intended to provide protection for members' interest or benefits in the pension scheme. Whereas qualitative governance takes into account the wider needs of members, and would endeavour to enhance members' retirement outcomes, particularly through avoiding the effects of:

- poor investment decisions
- unfavourable product or contract terms
- lack of understanding and knowledge
- poor decisions, such as those relating to retirement options.

Qualitative governance, therefore, covers matters that are not subject to legislative or regulatory prescription but rather, it is the area whereby the 'governance body' can add value by making informed, subjective judgments.

## What are the benefits of governance?

It is true that there is no legislative requirement for governance in relation to pension schemes (although it could be argued that trustees' common law duties imply good governance) but there are a number of advantages, as emphasised recently by the Pensions Regulator.

These include:

- Improving member understanding of, and confidence in, the pension scheme being offered. This, in turn, can lead to an increase in take-up and appreciation of the value of the employer's contribution (which is, after all, why the scheme has been established in the first place).
- Prevention, or early identification, of problems – for example, in relation to the payment of contributions, or around administration service standards. This can maintain members' confidence in the scheme and ensure that their experience of it remains favourable.

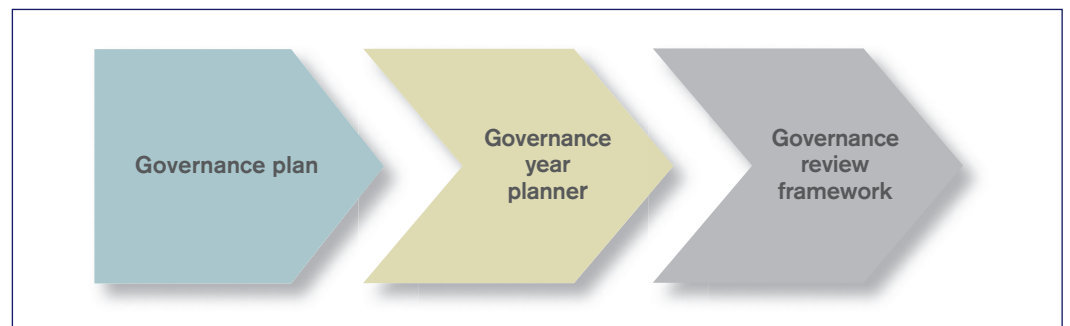
- Mitigation against the risk of a scheme being seen as poor quality and the accompanying reputational, recruitment and retention risks.

Research suggests that those responsible for DC plans believe that poor member understanding is the most serious risk for such schemes. Good governance can help mitigate this by providing a mechanism for understanding members' needs and requirements and working to meet these before any issues or problems arise.

The good news is that governance can be as simple or as complex as required, depending on what is appropriate for each scheme. We believe that there are three stages to good governance (see **Figure 1**) and these can be adapted depending on the level of complexity (or simplicity) required.

In the following pages we will talk through these three stages. But even for the simplest governance arrangement, sometimes it can be difficult just knowing where to start and we therefore concentrate on the first stage – the governance plan and how to get started.

**Figure 1** | Three stage approach to good governance



## Further information

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# The governance plan

In developing a governance plan, there are five simple steps to follow. These are shown in Figure 2 below.

## 1. Set the objectives

If governance is 'a set of processes to ensure a successful outcome', the first stage in any governance process will be to decide what makes a successful outcome –

for example, what are we trying to achieve with this pension scheme? Once these objectives have been defined it is easier to design the processes and internal controls required to monitor and achieve them. Objectives can be either strategic or operational and can be set by the sponsoring employer and/or the management committee or the trustees.

**Figure 2 |** The five simple steps to creating a governance plan



**Figure 3 |** Strategic objectives

| Example strategic objectives |   |
|------------------------------|---|
| People                       | The scheme should be broadly in line with those pension schemes offered by a competitor peer group.   |
| Finance                      | The total annual cost to the employer should not exceed 10 per cent of the annualised payroll in relation to all eligible employees (excluding the cost of life cover and ill-health benefits). |
| Administration               | For members, their individual involvement in the day-to-day administration of the scheme should be easy and flexible to suit their varying needs.   |

**Figure 4 |** Operational objectives

| Example operational objectives |   |
|--------------------------------|---|
| Management                     | To ensure the scheme is run in compliance with the Trust Deed and Rules and all relevant regulations and legislation. |
| Investment                     | To ensure the scheme's investment managers perform in line with agreed performance benchmarks.                        |
| Administration                 | To receive an efficient and transparent service from both the internal and external administrators.                   |
| Member communication           | Ensure that members have adequate and sufficient information to make suitable and informed investment decisions.      |

**Figure 5 | Example risk register**

| Risk   | Risk type      | Impact | Likelihood | Current controls                             | Management processes   | Risk owner  |
|--|----------------|--------|------------|--|--|---|
| Administrative errors/errors on member records | Administration | Medium | Low        | Administrator quality procedures             | Audit<br>Service level agreement                                     | Trustees or employer<br>Administrator or provider |
| Members make inappropriate investment choices  | Communication  | High   | Medium     | Investment guide<br>Default lifestyle option | Regular monitoring of member behaviour                               | Trustees or employer<br>Members                   |
| Breaches of legislation or regulations         | Administration | High   | Low        | Administrator processes and quality controls | Quarterly governance report<br>Trustees' knowledge and understanding | Trustees or employer<br>Administrator or provider |

## 2. Identify the risks

Having now set the objectives, it is important to identify anything that could present a risk to the scheme in achieving them. There are a number of ways this can be done; the most common being by way of a risk register. This document lists any issues the employer, management committee or trustees believe could affect the scheme's ability to achieve its objectives and shows how these risks are being monitored and mitigated. A risk register can also be used to show who has responsibility for each risk and its relative importance – for example, a combination of the likelihood of each event happening and the impact on the scheme, the member or possibly the employer if it did.

Considering some of the risks we have just discussed, an extract from the corresponding risk register could be as shown in Figure 5 (above).

The Pensions Regulator recommends that schemes use a risk register as part of their governance process and a sample risk register can be found on its website. Alternatively, your advisers may be able to help in drawing up a risk register and identifying areas for consideration.

## 3. Define how success will be measured

The objectives have now been set and any risks that may prevent these being achieved have been identified. The next stage is to decide how success will be measured and to set some key performance indicators (or KPIs). These KPIs can then be monitored to assess the scheme's performance and/or success in achieving its objectives. They can be derived from the scheme's objectives and the risk register.



Example KPIs can be seen in Figure 6.

Regular monitoring of performance against the KPIs is essential to ensure the scheme's objectives are being achieved.

The most common method of monitoring progress is to have a regular governance report. At the simplest level, for a contract-based scheme, this could be a six monthly or even annual report covering investment performance and administration service levels achieved.

Alternatively, at a more sophisticated level this could consist of quarterly reports from providers, administrators and/or advisors in which they report against the KPIs.

#### 4. Establish governance structure

Having agreed how performance will be measured and monitored, the next step is to decide who will carry out these tasks and ensure the objectives are achieved.

For a trust-based scheme, the trustees have responsibility for scheme governance and they may decide to do this through a regular item at trustee meetings or via a specialist sub-committee which reports back to the trustee board.

**Figure 6** | Example KPIs

| Objective   | KPIs   |
|---|--|
| Ensure that members have adequate and sufficient information to make suitable and informed investment decisions | Member investment behaviour<br>Member satisfaction   |
| To receive an efficient and transparent service from both the internal and external administrators              | Performance against service level agreement (SLA)<br>Timings of monthly contribution payments and investment |

**“ Regular monitoring of performance against the KPIs is essential to ensure the scheme’s objectives are being achieved. ”**

The Pensions Regulator believes that contract-based schemes can also benefit from periodic reviews and, in the recent guidance on voluntary employer engagement, suggested a number of ways in which this could be done:

- For larger schemes, the employer may wish to set up a management committee possibly with member representation.
- Trustees of an occupational scheme may be asked to keep a contract based arrangement under review. This maximises the benefits of their relevant knowledge and can act as a focal point for all pension related issues.
- For smaller, contract-based arrangements the HR department could have responsibility for monitoring the scheme.
- An advisor could be appointed to monitor the operation of the scheme and its suitability for the employer and members, reporting to the HR department or another nominated contact.

When considering who will take responsibility for scheme governance, it may also be appropriate to consider what level of employee representation is required and how this could be achieved.

Once the person or group with these responsibilities has been identified, it is important to set some terms of reference clarifying the role and what it entails (and crucially what it does not entail). These should ideally be linked to the scheme's objectives.

## 5. Draw up a governance plan

Having completed the previous steps, this can all now be pulled together to form a Governance Plan. This plan forms the basis of effective scheme governance and outlines how the scheme will aim to meet its objectives, monitor progress towards this and manage the risks that may prevent it achieving them.

Again, this plan can be as comprehensive or as simple as you like. For example, it could take the form of a 10 to 20 page document that provides significant detail on how the scheme is to be governed. Alternatively it could just be a simple table combining the output of the previous four steps.

Using some of the examples above, a simple governance plan could look something like that shown in Figure 7 (below).

**Figure 7 | Example of a simple governance plan**

| Objective   | Risks   | KPIs  | How will it be monitored?   | Who will monitor this?                                |
|---|---|---|---|---|
| To receive an efficient and transparent service from both the internal and external administrators              | Administrative errors/errors on member records<br>Breaches of regulations and legislation | Performance against service level agreement<br>Timings of monthly contribution payments and investments | Quarterly governance report including administration service statistics | Management committee/trustees                         |
| Ensure that members have adequate and sufficient information to make suitable and informed investment decisions | Members make inappropriate investment choices   | Member investment behaviour<br>Member satisfaction  | Member behaviour analysis in governance report<br>Annual member survey  | Management committee/trustees with assistance from HR |

# The year planner

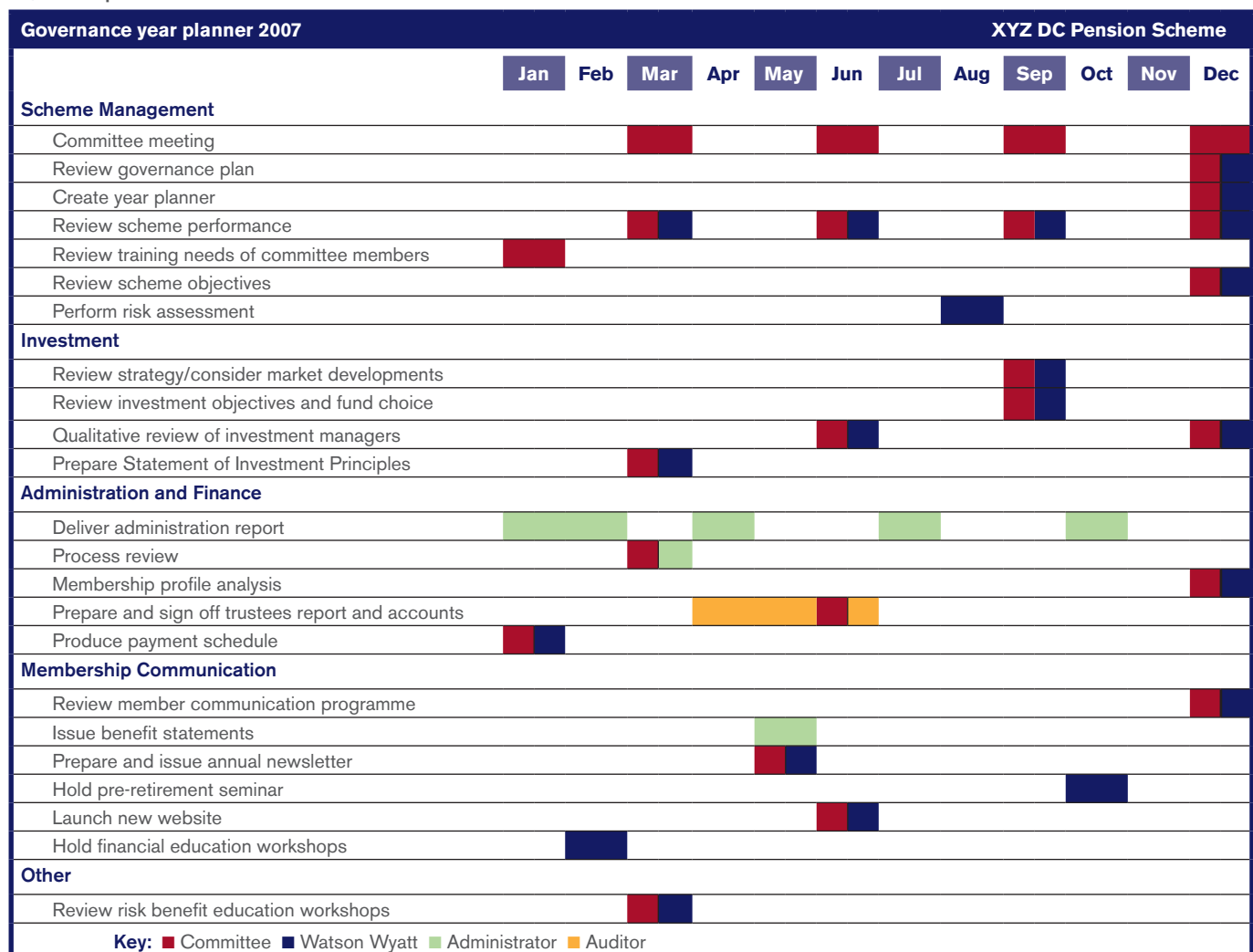
Once the governance plan is in place, it should be relatively simple to construct a year planner highlighting the occurrence of key events over the forthcoming year – for example, meetings, key audit and review items, strategy discussions, scheme enhancements and the issuing of key member communications.

The year planner essentially sets a forward agenda for the governing body and should not just include those things that have to be done but also those things that the governing body would like to do by way of enhancing the scheme.

When drawing up this plan it is essential to consider the resources and budgets available, since being realistic about these will greatly increase the chances of achieving the tasks set out in the year planner.

Some tasks may only be required every two or three years and may not appear on the first year planner, but if they are included on the governance plan they should come round for inclusion in future year planners.

**Figure 8 | An example of a year planner**



## The review framework

Whilst producing a governance plan and year planner is the cornerstone to a sound governance structure and process, it is not sufficient on its own.

Having established the 'rules of the game' the governing body then needs to carry out regular reviews and audits to measure the scheme and its performance against the objectives, risk measures and KPIs agreed and laid out in the governance plan.

Some of this review and audit activity will be 'one-off' events on an annual or, possibly, bi or tri-annual basis.

However, a significant part of the review and monitoring process will be a regular

(usually quarterly) governance review pack of information relating to the scheme's performance, investment arrangements, administration service and communication with members, as well as an analysis of the scheme membership profile and behaviour patterns.

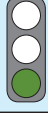
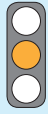
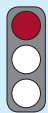
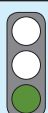
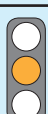
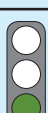
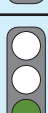
The key here is that by working through the above steps, you will have identified what management information you need to ensure the successful running of your DC plan. You should then ensure that that is exactly what you receive from your service providers and advisors – do not just accept what they want to give you!

“ **The year planner essentially sets a forward agenda for the governing body.** ”

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**Figure 9** | An example of a performance summary statement

| Performance summary  |  |
|--|--|
| Key Performance Indicator  | Traffic Lights   |
| <b>1. Member investment behaviour –</b><br>The majority of members invest in the Lifecycle Strategy.<br>No issues to report.   | See Section 3<br>   |
| <b>2. Member contribution behaviour –</b><br>Members are not taking full advantage of the employer's matching contribution rates.  | See Section 3<br>   |
| <b>3. Usage of Plan Internet site –</b><br>Member usage of the internet site has been low.   | See Section 3<br>   |
| <b>4. Investment manager performance and suitability –</b><br>No issues to report.   | See Section 4<br>  |
| <b>5. Administrative performance against service levels –</b><br>Service standards have deteriorated over the previous quarter and the provider will require close monitoring. | See Section 7<br> |
| <b>6. Unit reconciliation –</b><br>The scheme is fully reconciled.   | See Section 6<br> |
| <b>7. Member complaints –</b><br>No member complaints received during the quarter.   | See Section 7<br> |

You have limited governance time and resource and cannot afford to wade through huge quantities of information to find the most relevant information – if indeed you can find it amongst all the other information. Following this approach should enable you to be very focused and efficient in the use of your governance time and resource.

In fact, your regular governance review documents could just be a single page (see [Figure 9](#)) as it should be possible to distil an assessment of the scheme's performance down to just one page. In practice, you will probably still want some backing papers to provide

a little more detail but the advantage of this approach is that you only spend time looking into those areas of the scheme's performance for which there are issues of concern.

In summary, good governance need not be over-engineered and can be as simple as is appropriate for the scheme's particular circumstances, needs and requirements.

However, some focus is necessary to ensure the governance does not become a chore or a meaningless 'paper chase'.

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