

Defined Contribution Governance statement for the year ended 31 December 2018

Introduction

Governance requirements apply to defined contribution ("DC") pension arrangements like the DC Section of the Church Administrators Pension Fund ("CAPF"), to help members achieve a good outcome from their pension savings. The Church of England Pensions Board, the Board, as Trustee, is required to produce a yearly statement to describe how the governance requirements have been met in relation to:

- the investment options in which members can invest (this means the "default arrangement" and other funds members can select);
- the requirements for processing financial transactions;
- the charges and transaction costs borne by members;
- an illustration of the cumulative effect of these costs and charges;
- a 'value for members' assessment; and
- Trustee knowledge and understanding.

This Statement covers the period from 1 January 2018 to 31 December 2018.

Default Investment Arrangement

The default investment arrangement is designed for members who join the DC Section and do not choose an investment option. The Board is responsible for investment governance, and this includes setting and monitoring the investment strategy for the default arrangement.

When deciding on the investment strategy, the Board recognises that the majority of members do not take active investment decisions and instead invest in the default option. The default option is currently a lifestyle strategy, whereby members' assets are automatically moved between different investment funds as they approach their retirement date.

Details of the objectives and the Board's policies in regards to the default arrangement are set out in a document called the Statement of Investment Principles ("SIP"). The DC Section's SIP is available on our website, on request and it is appended to this annual report.

The aims and objectives of the default arrangement, as stated in the SIP, are as follows:

- To provide a prudent default arrangement for those that do not wish to make a choice;
- Provide an investment that should be easy to buy and sell;
- Reduces risk and cost to members by offering a passively invested fund;
- To review the arrangement to make sure it is fit for purpose.

The default arrangement was last reviewed in 2017. As part of this review, the Trustee decided to appoint Legal & General to manage a Target Date Fund ("TDF") strategy. This follows an initial review conducted in 2015, where the Board agreed to replace the default arrangement from a lifestyle strategy targeting annuities to a TDF strategy. This decision was made to allow members additional flexibility to access the new retirement freedoms. The switch to this new arrangement took place in February 2019. The Board monitors the performance of the default strategy on an annual basis and will review the new default arrangement at least every three years or immediately following any significant change in investment policy or the CAPF DC Section's member profile.

Requirement for processing core financial transactions

Processing of core financial transactions (eg investment of contributions, processing transfers within and into/out of the DC Section, and payments to members/beneficiaries) is carried out by the administration team of the Church of England Pensions Board.

The administration team have confirmed to the Board that there are adequate internal controls to ensure that core financial transactions relating to the DC Section are processed promptly and accurately.

CAPF has a service level agreement ("SLA") in place with the administration team which covers the accuracy and timeliness of all core transactions. The key processes adopted by the administration team to help them meet the SLA are as follows:

- Process management within the administration system detailing time outstanding to complete tasks within their assigned SLA;
- Weekly reporting to senior managers detailing any SLA failures and reason for failure;
- Daily monitoring of emails by an assigned member of staff;
- Daily monitoring of bank accounts; and
- Checking by two people of investment and banking transactions.

The Board receives annual reports about the administration team's performance, and based on information provided by them, is satisfied that over the period covered by this statement:

- there have been no material administration errors in relation to processing core financial transactions; and
- all core financial transactions have been processed within a reasonable timeframe.

The Board is satisfied that this is the case as there have been no breaches reported in the quarterly administration reports.

Defined Contribution Governance statement (continued)

Member-borne charges and transaction costs

The Board is required to set out the on-going charges incurred by members in this Statement, which are annual fund management charges plus any additional fund expenses, such as custody costs, but excluding transaction costs); this is also known as the total expense ratio ("TER"). The TER is paid by the members and is reflected in the unit price of the funds. The stated charges exclude administration costs since these are not met by the members.

The Board is also required to disclose the level of any transaction costs. These are incurred when the DC Section's investment managers buy and sell assets within funds, but are exclusive of any costs incurred when members invest in and switch between funds. The charges and transaction costs have been supplied by the DC Section's investment manager, Legal & General. When preparing this section of the statement the Board has taken account of statutory guidance.

Default arrangement

For the period covered by this statement, the default arrangement has been set up as a lifestyle approach, whereby members' assets are automatically moved between different investment funds as they approach their retirement date. Therefore, the level of charges and transaction costs vary according to each member's proximity to retirement and the underlying funds they are invested in. More specifically, the annual charges ranged from 0.20% to 0.11% during the period covered by this statement. As of February 2019, the default arrangement has been switched to a Target Date Fund strategy. This will result in different annual charges and transaction costs in next year's Governance Statement.

Years to retirement	Annual charge	Transaction costs
5 or more years to retirement	0.20%	0.05%
4 years to retirement	0.18%	0.05%
3 years to retirement	0.16%	0.05%
2 years to retirement	0.14%	0.04%
1 year to retirement	0.13%	0.04%
At retirement	0.11%	0.04%

Self-select options

In addition to the default lifestyle, members also have the option to invest in an ethical lifestyle strategy. The annual charges for this lifestyle ranged between 0.25% and 0.11% during the period covered by this statement.

The level of charges for each self-select fund (including those used in the default arrangement) and transaction costs over the period covered by this statement are set out in the following table. The underlying funds used within the current default arrangement are shown in bold.

Manager – Fund name	Annual charge	Transaction costs
LGIM Ethical UK Equity Index	0.200%	0.01%
LGIM Ethical Global Equity Index Fund	0.300%	0.01%
LGIM UK Equity Index Fund	0.100%	0.00%
LGIM Overseas Equity Consensus Index Fund	0.250%	0.00%
LGIM Global Equity Market Weights (30:70)	0.200%	0.05%
Index Fund		
LGIM Over 5 years UK Index-Linked Gilts	0.100%	0.05%
Fund		
LGIM Over 15 years Gilts Index Fund	0.100%	0.00%
LGIM AAA-AA-A Corp Bond All Stocks Index	0.150%	0.00%
Fund		
LGIM Managed Property Fund	1.070%	0.00%
LGIM Cash Fund	0.125%	0.00%

Additional voluntary contributions

All contributions, including Additional Voluntary Contributions, are managed in the same way as set out above.

Defined Contribution Governance statement (continued)

Illustration of charges and disclosure costs

The following table sets out an illustration of the impact of charges and transaction costs on the projection of an example member's pension savings.

- The "before costs" figures represent the savings projection assuming an investment return with no deduction of member borne fees or transaction costs. The "after costs" figures represent the savings projection using the same assumed investment return but after deducting member borne fees and an allowance for transaction costs.
- The transaction cost figures used in the illustration are those provided by L&G over the last year, subject to a floor of zero (ie the illustration does not assume a negative cost over the long term).
- The illustration is shown for the default option since this is the arrangement with the most members invested in it, as well as four funds from the DC Section's self-select fund range. The four self-select funds shown in the illustration are:
 - the fund with the highest before costs expected return – this is the LGIM Global Equity Market Weights (30:70) Index Fund
 - the fund with the lowest before costs expected return – this is the LGIM Cash Fund
 - the fund with highest annual member borne costs – this is the LGIM Managed Property Fund
 - the fund with lowest annual member borne costs – this is the LGIM UK Equity Index Fund

Years invested	Default option		LGIM Global Equity Market Weights (30:70) Index Fund		LGIM Cash Fund		LGIM Managed Property Fund		LGIM UK Equity Index Fund	
	Before costs	After costs	Before costs	After costs	Before costs	After costs	Before costs	After costs	Before costs	After costs
1	£13,300	£13,300	£13,300	£13,300	£12,700	£12,700	£13,100	£13,000	£13,300	£13,300
3	£19,800	£19,700	£19,800	£19,700	£17,600	£17,600	£19,100	£18,600	£19,800	£19,700
5	£26,700	£26,500	£26,700	£26,500	£22,400	£22,300	£25,300	£24,400	£26,700	£26,600
10	£46,400	£45,600	£46,400	£45,600	£33,600	£33,400	£42,100	£39,300	£46,400	£46,100
15	£69,700	£68,100	£69,700	£68,100	£44,100	£43,600	£60,500	£54,800	£69,700	£69,000
20	£97,400	£94,400	£97,400	£94,400	£53,800	£53,000	£80,900	£71,200	£97,400	£96,200
25	£130,300	£125,300	£130,300	£125,300	£62,800	£61,700	£103,400	£88,200	£130,300	£128,300
30	£169,400	£161,600	£169,400	£161,600	£71,100	£69,700	£128,300	£106,100	£169,400	£166,200
35	£215,800	£204,100	£215,800	£204,100	£78,900	£77,100	£155,700	£124,900	£215,800	£211,000
40	£234,400	£220,500	£270,900	£254,000	£86,000	£83,900	£186,000	£144,500	£270,900	£264,000

Notes

- Values shown are estimates and are not guaranteed. The illustration does not indicate the likely variance and volatility in the possible outcomes from each fund.
- Projected pension pot values are shown in today's terms, and do not need to be reduced further for the effect of future inflation.
- Inflation is assumed to be 2.5% each year.
- The starting pot size used is £10,200 which is broadly in-line with the average active member.
- The starting salary is assumed to be £33,500 which is broadly in-line with the average active member.
- Salaries could be expected to increase above inflation to reflect members becoming more experienced and being promoted. However, the projections assume salaries increase in line within inflation to allow for prudence in the projected values.
- Contributions are assumed to be 8% per year, as this is the employer's contribution for members under 30 years of age.
- Values shown are estimates and are not guaranteed. In particular, the illustration does not indicate the variance and possible volatility in the possible outcomes from each fund.
- The projected annual gross of fee returns used are as follows:
 - Default option: 3.5% above inflation for the initial years, gradually reducing to a return of 1.5% *below* inflation at the ending point of the lifestyle.
 - LGIM Global Equity Market Weights (30:70) Index Fund 3.5% above inflation
 - LGIM Cash Fund 1.5% *below* inflation
 - LGIM Managed Property Fund 2.0% above inflation
 - LGIM UK Equity Index Fund 3.5% above inflation
- No allowance for active management has been made.
- This basic illustration, unlike the annual SMPI statements issued to scheme members, does not take account of the CAPF DC scheme design of increasing employer contribution rates as the scheme member gets older.

Value for members assessment

The Board is required to consider the extent to which the investment options and the benefits offered by the DC Section represent good value for members, compared to other options available in the market. There is no legal definition of "good value" and so the process of determining good value for members is a subjective one. The general policy of the Board in relation to value for member considerations is set out below.

It is the Board's policy to review all member borne charges (including transactions costs where these are available) on a regular basis, with the aim of ensuring that members are obtaining value for money given the circumstances of the DC Section. The Board notes that value for money does not necessarily mean the lowest fee, and the overall quality of the service received has been taken into account in the 'value for members' assessment. The Board's advisors have confirmed that the fund charges are competitive for the types of fund available to members.

Defined Contribution Governance statement (continued)

The Board's assessment included a review of the performance of the DC Section's investment funds (after all charges) in the context of their investment objectives. The returns on the investment funds members can select during the period covered by this statement have been consistent with their stated investment objectives, except for the actively managed property fund, which underperformed its benchmark over the year. The Board will continue to monitor the performance of the investment funds closely.

The Board also considers the other benefits members receive from the DC Section, which include: the design of the default arrangement and how this reflects the interests of members; the range of investment options and strategies; the efficiency of administration processes and the extent to which the administration team met and exceeded its service level standards for the year; the quality of communications delivered to members; and the quality of support services and scheme Governance. As detailed in the previous section covering processing of financial transactions, the Board is comfortable with the quality and efficiency of the administration processes.

Overall, the Board believes that members of the DC Section are receiving good value for money. The Board aims to improve this further by looking for opportunities to reduce fees for members, setting aside more time at Trustee meetings to discuss DC matters and considering the retirement options available via the DC Section (particularly once the new strategy has been implemented).

Trustee knowledge and understanding

The members of the Pensions Committee / Trustee Board are required to maintain appropriate levels of knowledge and understanding.

The Board has measures in place to secure compliance with the legal and regulatory requirements regarding its knowledge and understanding including investment matters, pension and trust law. This, together with the advice available, enables the Board to properly exercise its functions and run the DC Section properly and effectively. A Trustee training log is maintained in line with best practice.

During the year covered by this statement, they have ensured their knowledge and understanding is up to date by:

- Completing the Pension Regulator's Trustee Toolkit;
- Receiving formal and informal training at relevant Trustee Board and Committee meetings, including training on GDPR and corporate fraud; and
- Where appropriate, completing self-assessments of training needs.

In addition, the Board reviews the trust deed and rules, SIP and all other documents setting out the Board's current policies as appropriate to ensure they have a good working knowledge of these documents.

Taking into account the knowledge and experience of the Board with the specialist advice (both in writing and whilst attending meetings) received from the appointed professional advisors (eg investment consultants, legal advisors), the Board believes it is well placed to properly exercise its functions as Trustee of the CAPF DC Section.

Approval

The DC Governance Statement was approved by the Trustee on 25 June 2019 and signed on its behalf by:

Clive Mather
Chairman of the Church of England Pensions Board