Summary

- Smaller scheme trustees may be reluctant to correspond about transfers due to concerns over providing misinformation, especially if they cannot afford guidance on this by a third party.
- Small schemes can end up paying four and a half times the cheapest fee available for the administration.
- Investment considerations are likely to be bottom of the pile, with the focus on the minimum spend to keep on right side of the regulator.
- Small schemes' trustees and sponsors need to agree on an endgame and timescales for achieving this.
- Fiduciary management is a growing trend in the small scheme space.
- The days of small trust-based DC schemes are limited, due to their increasing cost burden and lack of economies of scale.

An uphill battle

From limited resources to weak negotiating positions, small schemes have got the odds stacked against them as governance expectations pile up, finds Marek Handzel

The Pensions Regulator tried its best to hide its anger when it revealed back in June that it had found 74 per cent of small DC trust-based schemes have little or no knowledge of its DC quality features.

But there couldn't have been much surprise in the watchdog's Brighton offices when its survey results were first totted up. As Baker Tilly director Karen Tasker points out, legislation in relation to DC now almost outstrips that surrounding DB, leaving trustees of small schemes playing a dangerous game of catch up.

"There's so much that they need to be aware of and without the resources I don't see how they can comply with all the regulation," says Tasker.

Matters aren't much better for trustees of DB schemes either.

"Smaller DB schemes are under pressure from all angles," explains Pinsent Masons head of pensions Carolyn Saunders.

"Buying out is unachievable, but simply maintaining business as usual is also a challenge. The compliance burden for smaller schemes is disproportionate and for the most part there will be little in-house pensions support at the sponsoring employer."

What's more, she says, DB schemes feel irrelevant because its members typically no longer have any connection with sponsoring companies. And yet their underfunding is such that they cannot be ignored because of their impact on the wider business.

Hurting

Inevitably, the pressure on smaller trust-based schemes leads to mistakes being made.

Tasker says that there have been cases, in the wake of the new pension freedoms, of trustees being reluctant to respond to correspondence over transfers for fear of providing incorrect information.

"If you have the resource then you

can ask lawyers to respond to that, but some trustees may end up misinforming members as they cannot get guidance from a third party or have a lack of training," she says.

In relation to scheme management, she says that some schemes have failed to renegotiate terms with administration providers, leaving them being charged high amounts. Recent research from Kim Gubler Consulting found that some small schemes were paying out four and a half times the cheapest fee available for their administration.

"They are now having to think about costs under new legislation but it doesn't help that in years gone by charges have been quite extortionate," says Tasker.

Getting the house in order

Costs have become a major preoccupation for DC trustees ever since the former pensions minister Steve Webb declared war on high provider charges. But J.P. Morgan Asset Management head of UK DC Simon Chinnery is not convinced that such an approach has helped overall member saving outcomes.

Smaller schemes, he argues, should be focusing on getting their default fund (where most of their members will be) up to the standards expected by the regulator. But it is likely that investment considerations are bottom of the pile for most of them.

"They may be focused purely on what the minimum spend is to keep on the right side of the regulator at the cost of best investment solutions for their members," says Chinnery.

"It would be good to see the default getting more governance airtime. This is not about wishing trustees spending endless hours reviewing different fund managers and asset classes – that largely didn't work in DB so there is no reason to think it will work better in DC – but to look at professionally managed off-the-shelf glidepath solutions as offered by target date funds."

Defaults are still neglected in the DC world by smaller schemes, but for smaller DB schemes it is the ultimate destination of a scheme that is almost passed over by many DB trustees.

The need to have goals in place to avoid funding disasters is one that many smaller schemes have not yet grasped, says SEI director of European institutional advice Charles Marandu.

"There is a need for trustees and sponsors to agree on their endgame and what the timescales are. So whatever it is, it then drives what investment and financing policies are suitable today.

"If you don't have the endgame in sight, then it's very difficult."

With a clear flightpath in mind, a sponsoring employer can also be more confident that its DB scheme will not unexpectedly hold its business plans back, particularly if it decides to merge with another business or is open to a takeover.

"The quantum of the deficit in an M&A is never attractive, but it's not just that. It's the potential of that deficit to move against you," says Marandu.

He says that DB trustees have to consider how big a deficit could grow by taking a holistic approach and talking about investment risk going hand-in-hand with a sponsor's covenant.

Punter Southall head of investment consulting Danny Vassiliades says that getting a better picture on investment is also one of the only ways that small scheme trustees can actually control their workload. There's not a lot that

can be done about trustees having to be replaced, or dealing with administration and actuarial valuations, he says, but one area where arrangements can be streamlined is investment.

"It's important that they don't make things so complicated that they make additional work for themselves that they don't need," he argues.

One way of doing so is through the appointment of a fiduciary manager, a growing trend in the small scheme space.

A mastermind

Earlier this year Deloitte launched its Pensions Master Plan, a multi-employer pension plan designed specifically for DB schemes. The move signalled the increasing attraction of pooled governance solutions.

The Pensions Trust head of strategy and business development Paul Murphy says that the organisation is being approached by DB schemes that are looking for a way out of the cost and governance conundrum they face.

"Schemes are finding economies of scale a challenge and they are struggling to find trustees," he says. "Most schemes are closed and it means that most people have left the company or are retired and there are very few active members left to be trustees. Plus, the weight of legislation continues to be more onerous year in year out.

"When they come into a master trust you go out to market and you can buy things at a fraction of the price. We have £7 billion of purchasing power. And we provide far more robust governance. You're removing the concerns of the existing trustees and placing it firmly in a corporate structure dedicated to that."

In the DC arena however, Chinnery is not quite sold on master trusts. He says that it is better to wait until an increased regulatory focus brings consolidation to the market and creates industry best-practice models.

"However, the days of small DC trust-based plans are probably limited, given increasing cost-burden to the corporate sponsor and lack of economies of scale to gain better pricing and advice."

Written by Marek Handzel, a freelance journalist

A trustee's perspective

Paul Meier is a scheme trustee of the Star Group pension fund. He reveals how he and his fellow trustees try to cope with limited resources.

"Our DB scheme is about £200 million. The DC section of our scheme is approximately another £60 million.

"DC sections do tend to be the Cinderella but we have a body of work going on to tick the TPR boxes on DC governance, and most of what the TPR wants is the appearance of ticking boxes. On investments available to DC members, costs incurred by DC members, and options at retirement, I think we do a good job.

"Those are the essential requirements for DC members. In particular, we are able to buy sophisticated lifestyle products for our DC members at 25-30 basis points from Blackrock.

"We are a family business and our next generation is now in the business aged about 30, so succession is not really an issue. What is an issue are the restrictions a DB scheme places on being able to trade any underlying businesses. For instance in our industry, newspaper publishing, it is more or less impossible to sell or buy a business without triggering S75 claims from DB trustees and the regulator.

"The burden of governance is very heavy."