Small spaces

Jack Gray ponders whether there's any space for small defined benefit schemes in today's market

As the DB pensions landscape gradually shifts towards consolidation, smaller DB schemes could become a thing of the past. Larger vehicles may represent a more stable and less expensive option to smaller employers who wish to try and minimise insolvency risk by becoming part of a consolidated scheme.

However, some smaller DB schemes are effective at meeting the needs of stakeholders. Every employer is different, and smaller schemes could offer a more tailored and personal service that a large master trust would find it more difficult to provide.

Relevance

With the industry focused on DB scheme consolidation, it could be argued that the relevance of the smaller schemes is waning. However, smaller DB schemes are currently very commonplace, and although master trusts could be the future, it is impossible to say how long it will be before they are widely adopted.

"Around 4,000 DB schemes have assets below £100 million, which represents a massive 74 per cent of all DB schemes in the UK," says Hymans Robertson partner and head of trustee DB, Susan McIlvogue. "Therefore, small schemes are very relevant in the current market."

Barnett Waddingham associate, Tom Hargreaves adds: "Schemes with less than 1,000 members make up 80 per cent of the UK's DB schemes by number, but only represent around 10 per cent of the total liabilities. A lot of focus is therefore placed on the larger schemes which make up the majority of the liabilities."

Small issues

Despite this, McIlvogue admits that smaller DB schemes are "facing significant challenges that need to be addressed in order to improve the security of peoples' retirement income".

"The regulatory burden on trustees is immense and shows no sign of reducing," begins TPT Retirement Solutions head of direct distribution, Adrian Cooper. "This at a time when replacing trustees is becoming more difficult year-on-year as the candidate pool diminishes. Smaller schemes are also unable to access sophisticated funding and investment strategies."

Due to their size and funding, some smaller DB schemes find it difficult to keep up with the ever-increasing regulations and requirements.

"Increased complexity changes in legislation, regulation and governance have made the maintenance of small DB scheme less attractive or viable," says Citrus DB Master Trust employer nominated trustee, Michael Penny, "DB schemes are declining and so is employer priority, especially for employers where the DB scheme is closed and where attention is needed to ensure successful outcomes of DC schemes that are acquiring new members."

Consolidation

The perceived poor value for money offered by smaller schemes is compounded by a recent study from Citrus, which reveals that smaller DB schemes could save up to £700,000 in costs, if they group together when targeting full buyout. It finds that schemes with assets under £10 million could expect to save around £400,000, while schemes with assets under £50 million could save up to £700,000.

"Key advantages associated with DB consolidation include much lower operating costs. Many schemes have multiple advisers and cost per member scheme charges can be disproportionate," adds Cooper. "Other advantages include time saved by the finance director and executive team managing the scheme – our small schemes survey showed that financial directors were spending as much as 45 days per year on their scheme – at huge opportunity cost."

So is there anything smaller DB schemes can do to stay relevant?

"The key task is managing liabilities and ensuring pensions are paid," says SSGA head of pensions and retirement strategy, Alistair Byrne, "Larger schemes have significantly adopted liability-driven investing approaches, often on a segregated basis. Smaller schemes can adopt similar strategies using LDI pooled funds.

"Often these funds have been less efficient or flexible than segregated approaches, but new strategies that are more capital and collateral efficient are becoming available."

Written by Jack Gray

Sink or swim

Jack Gray explores the future of smaller defined contribution schemes and whether they provide good value for members

DC pensions are becoming more commonplace as the industry moves away from DB pensions, but the future of smaller DC schemes could be under threat. Higher governance, increasing costs and consolidation are casting doubt on the viability of smaller DC schemes.

Member value

In September 2018, The Pensions Regulator (TPR) released its annual DC survey. It found that the trustees of just one in 10 'small' schemes and one in three 'medium' schemes are doing "everything which TPR believes is essential to assess value for members". This includes having good knowledge and understanding of member costs and charges, and completing a yearly assessment of the value the scheme provides.

The same study also found that just 41 per cent of trustees are researching what members value and taking it into account.

Governance

Improved governance for pension schemes could also present a threat to the future of smaller DC schemes. Although more stringent regulations could improve member experience and outcomes, the increased costs and time taken can have a negative impact on smaller schemes as they don't have the funds or manpower of the bigger schemes.

Increasing governance will also require trustees to plan ahead to deal with the changes, as Hymans Robertson partner and senior investment consultant Rona Train explains: "Pension scheme governance is becoming an increasing priority for smaller DC schemes, as ramped up Chair's Statement requirements come into force this year.

"This will be a significant change and by now even the smaller schemes should be making plans on how they will deal with the additional costs and charges disclosure requirements it will bring."

Consolidation

One of the possible solutions to dealing with increased governance and satisfying members' needs could be consolidating DC schemes into master trusts. The current debate on the merits of master trusts will most likely rage on until they have been tested in the real world.

Train suggests that they could be a positive change for the industry, saying: "For every well-governed smaller DC scheme there are likely to be more schemes struggling under the burden of increased regulation and governance requirements. For these schemes, moving to a master-trust arrangement may not only be a viable option, but could also lead to better retirement outcomes for their members."

Despite this, River and Mercantile Solutions head of DC solutions, Niall Alexander, says that consolidation isn't for everyone and small DC schemes still have a role to play.

He says: "There is a place for smaller schemes in today's DC landscape, and we are having lots of conversations with trustees who are telling us they are very happy not consolidating.

"This is primarily driven by paternalism: employers want to be able to demonstrate they are looking after their employees by appointing best of breed advisers and suppliers to get the best possible outcomes for members, and this is best done by keeping the pension scheme in house rather than relying on one provider."

However, this may not be the case with all smaller DC pensions, as TPR's annual DC survey found, but Alexander insists there are other reasons small DC schemes may not want to consolidate into a master trust.

"A small scheme can often pay the same investment fees as a larger scheme. It can access the same suite of investment funds: from passive index-tracking funds or ETFs, through to more actively managed strategies or non-daily dealt funds," he explains. "And crucially, this means we as investment advisers can give the same investment advice to all schemes – size is not an impediment to small scheme success."

It seems as if the jury is still out on the way to make the most of a smaller DC scheme, and it may take some real-world experimenting before we know what future role they have to play.

Written by Jack Gray

A small fish in a big pond

Consolidation and member uncertainty could pose threats to small pension providers. Jack Gray examines whether they have any influence in today's market

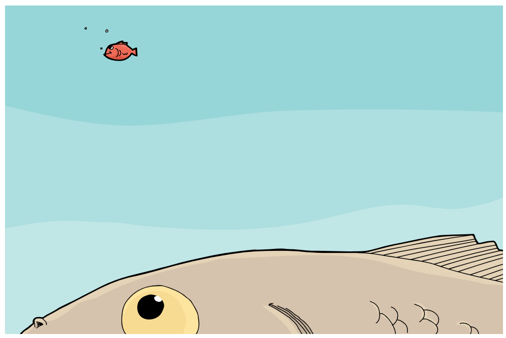
Smaller pension providers could face an uncertain future as the market shifts towards consolidation and greater emphasis is placed on member security. It seems as if it is difficult for small providers to ensure members have the same level of stability as they would have with the larger providers, but it does not necessarily mean that they are irrelevant.

Obstacles

In order to compete, smaller providers need to be able to convince employers that they can provide the same, if not better, value to their members than the larger providers. However, this could be easier said than done as smaller providers' resources are often dwarfed by those of, for example, Nest or Aviva. With members likely to be more interested in having a scheme that presents little risk, we could see the influence of smaller providers on the market starting to wane.

This, in part, has led to the industry moving towards consolidation, which could spell bad news for the smaller pension providers, as it is typically the large providers that are able to establish and run master trusts.

Furthermore, master trusts could help the bigger providers become even bigger, potentially squeezing small schemes out of the market. Barnett Waddingham partner, Paul Leandro, explains: "As more and more small schemes transition to larger master trusts, and the master trust consolidates, we will have less market competition. Then we could have the scenario, like in Australia, where the larger schemes will



not have to put in much effort to secure members' contributions.

"This could naturally stem the spend on innovation, as the argument could be that from the providers' perspective, 'there is no reward for innovation.'"

A recent study from Lincoln Pensions finds that more than half (52 per cent) of pension professionals believe that superfunds will become 'more commonplace', which could be bad news for small providers. However, the same survey finds that 35 per cent believe it will become a 'highly unusual approach applicable to only a very small number of schemes'.

Lincoln Pensions director, Adolfo Aponte says: "While superfund consolidation is not going to be right for everyone, it is clear that pension professionals believe it could be right for a number of schemes, if an appropriate regulatory framework can be put in place."

Potential solutions

Despite the issues, smaller providers could offer flexibility and a more personal experience that many of the larger providers cannot. In order to remain relevant, smaller providers may have to stand out amongst the bigger providers. Barnet Waddingham partner, Mark Futcher, insists that this is possible through offering unique benefits.

"Small pension providers will have to offer something different and enhance value over the stability, efficiency and economies of scale that larger providers offer," he says. "This is likely to be in the form of bespoke niche services, or having taken advantage of new technology on a more 'start up' basis."

Smaller providers could entice employers and employees by offering services that focus on issues that the member may be passionate about, such as responsible investing, prioritising environmental, social and governance factors or favouring high risk, high reward strategies.

Influence

In order to remain influential in the pensions landscape, smaller providers may have to become experts in creating bespoke services that will set them apart from the competition. However, some schemes seem to have already realised this. Futcher says: "There is clear evidence that smaller pension providers are influencing the market. Some are technology heavy and aimed at small and medium-sized enterprises, which had to comply with auto-enrolment, and are now becoming mainstream, with ideas and technology filtering into the major providers."

This could quell some of the fears consumers have, as they may be willing to sacrifice stability to get the pension that is perfect for them. Futcher concludes: "The ability to be nimble, innovative and change old ways of working is vital in the DC pensions market."

Written by Jack Gray