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Reducing costs without compromising control – *Paul Yates explains how trustees and companies can gain the benefits of defined benefit pension scheme consolidation, without sacrificing control over their scheme* *p56*

A road to take? – *Pensions Age takes an in-depth look at the consolidation of DB schemes into master trusts, where this shift originates, and the benefits and drawbacks for schemes deciding to go down this route* *p58*

DB master trust focus:

Coming together

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Reducing costs without compromising control

Paul Yates explains how trustees and companies can gain the benefits of defined benefit pension scheme consolidation, without sacrificing control over their scheme

There has been much focus recently on the advantages that defined benefit pension schemes can gain from consolidating into a larger arrangement.

In particular, the White Paper published by the Department for Work and Pensions (DWP) in March 2018 concluded that there are significant potential benefits for employers and schemes through consolidation.

In the past, to gain those benefits, trustees and companies have generally had to let go of a significant amount of the control they have over their scheme.

However, innovative solutions are now available which can reduce scheme costs without the disadvantage of a loss of control.

With several different options to choose from, this article considers how trustees and companies can decide whether consolidation is right for their scheme.

Should my scheme consider consolidation?

For the majority of UK pension schemes, the answer is 'yes'.

Consolidation can offer significant cost reductions. Being part of a larger overall arrangement can bring economies of scale, which will benefit trustees, scheme members and sponsoring companies.

The savings are worth seeking out. For most schemes, insurance company buyout is unlikely to be a realistic prospect in the near term. The aggregate savings of reduced ongoing costs year after year will therefore build up to a significant amount.

One of the schemes that moved into Deloitte's consolidation arrangement, the Deloitte Pensions Master Plan, saw its ongoing expenses reduce by 30 per cent.

What are the options?

The options now available broadly fall into one of the following three categories.

The first is defined benefit master trust pension schemes. An existing scheme will transfer its assets and liabilities into the master trust in order to join. The current employer would continue to support the scheme after the transfer. The Deloitte Pensions Master Plan is a master trust, and the diagram below illustrates the joining process.

The second is adviser appointment arrangements, where one or more specified advisers are appointed in combination to run or provide services to the existing scheme.

The third option is a superfund, sometimes termed a commercial consolidator. Superfunds involve separating the pension scheme's assets and liabilities from the employer, with additional contributions being paid or security put in place as mitigation. These are a new kind of arrangement, and very careful consideration would need to be given in advance of a transfer to a superfund.

Retaining control by keeping your scheme's trustees

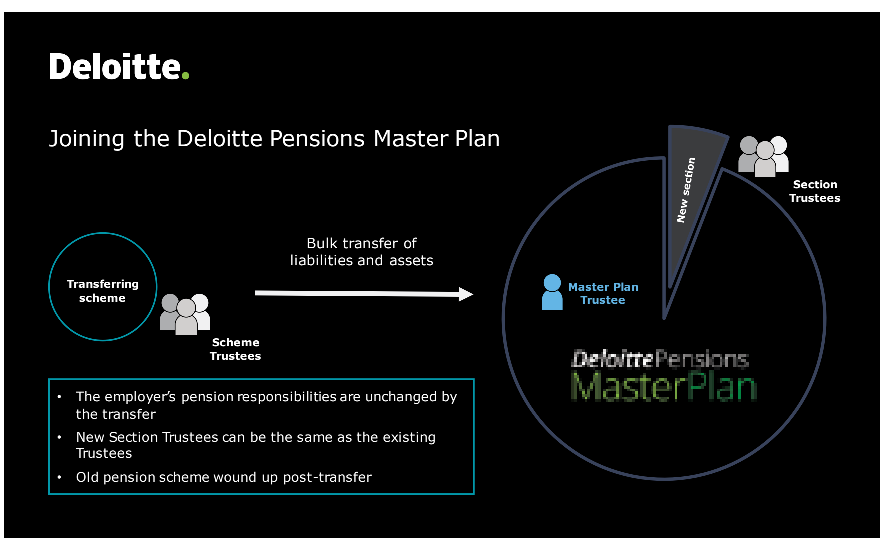
Different options will suit different schemes.

However, one key factor will be who controls the pension scheme post-consolidation.

The decisions that trustees make over issues such as how to invest the assets and the pace of scheme funding have a significant impact on benefit security for members and on the employer's costs.

It is Deloitte's view that for a consolidation option to be widely suitable for schemes in general, a key feature will be the ability for the current trustee board with its knowledge and experience to remain in place.

Even where trustees may be looking to retire from their role and a sole independent trustee is being considered, the ability to appoint trustees is a key power that should be retained.



Which option might be right for my scheme?
Deloitte recognised the advantages of consolidation several years ago, and in response developed the Deloitte Pensions Master Plan.

We believe the Master Plan's key features make it an optimal solution for a wide range of UK pension schemes:

• A master trust structure with all assets held in separate sections under the same trust, enabling savings from economies of scale.

• Designed to be fit for purpose, with clear segregation of assets between sections, and the original scheme's member benefits and balance of powers preserved after the transfer to the master trust.

• A unique structure that enables the original scheme's trustees to be retained with their key powers unchanged.

How do I assess whether to consolidate?
While defined benefit scheme consolidation is new, the underlying concepts (superfunds excluded) are not. Master trusts are essentially multi-employer pension schemes, and the bulk transfer mechanism to join them is a well-understood legal process.

Deloitte's approach to assessing a consolidation proposal is summarised in the table below. While different types of consolidation will have different points of focus, we believe the table captures the key points to consider.

The Deloitte Pensions Master Plan was designed to make a decision to transfer in straightforward, and there are simple answers to how the Master Plan address the questions in the table. Assessment should not be a time-consuming process.

For many consolidation options, especially those that involve a bulk transfer of assets and liabilities to a new pension scheme, trustees will need to take legal advice. The Master Plan has been assessed by a number of legal advisers and Deloitte can provide materials to help legal advisers quickly understand the key features.

Deloitte approach to assessing a consolidation proposal

Benefits	What are the expected benefits of consolidation? Are there any disadvantages?
Costs	What are the costs post-consolidation? Are costs transparent?
Implementation	How is consolidation achieved? What is the mechanism? What are the costs?
Segregation	Are the scheme's assets and liabilities ring-fenced from those of other pension schemes?
Member benefits	Will members' benefits change?
Employer covenant	Will the employer covenant change?
Provider	Who is the provider of the consolidation vehicle? What is their role and track record?
Scheme decisions	Who has responsibility for decisions? Are they independent of the provider?
Control	Will there be any changes to the trustees, or to who appoints and removes trustees?
Balance of powers	Will there be any changes to how powers in the scheme are worded or who exercises the powers?
Investments	Who controls the investment strategy? Are there any restrictions on investments?
Advisers	Who are the professional advisers and who chooses them? How can I be sure of their performance?
Exit	Can a scheme exit the consolidation solution after joining?

How will the market develop?
Superfunds have received some notable press coverage, and in the White Paper DWP committed to consulting later this year on a legislative framework and authorisation regime for superfunds. However no one form of consolidation will be right for all schemes. One superfund is quoted as saying that around 10 or 15 per cent of the market will be able to benefit from its solution. Other forms of consolidation will be needed if pension scheme costs are to reduce substantially across the industry.

There are a great many pension schemes that could benefit from existing forms of consolidation, like master trusts, and DWP are due to consult on an accreditation regime to help build confidence and encourage such solutions.

We expect DWP's accreditation regime will accelerate the increasing momentum of schemes joining consolidation arrangements.

How do I find out more about consolidation options?
Most consolidators will be pleased to discuss their offering with any schemes or companies that are interested in reducing their pension costs.

Deloitte will be pleased to discuss the Deloitte Pensions Master Plan or consolidation options more generally. You can email us for more information at: deloittepensionsmasterplan@deloitte.co.uk

Written by Paul Yates, senior manager, Deloitte

In association with Deloitte.

A road to take?

Summary
• It is estimated that the number of DB schemes in the UK may shrink by nearly 82 per cent in the next 25 years.
• Despite this, many trustees – particularly of smaller schemes – are unfamiliar with the process of consolidation.
• The near future seems set for major legislative overhaul, although it is still unclear as to which direction this will take.

Pensions Age takes an in-depth look at the consolidation of DB schemes into master trusts, where this shift originates, and the benefits and drawbacks for schemes deciding to go down this route

With a low rumbling that builds in volume and intensity the closer and closer it draws near, the conversation being had around defined benefit (DB) pension schemes and their consolidation into master trusts has gathered pace and become louder in the past year.

In February, Hymans Robertson released a report called *DB Consolidation: When, Not If*. That report predicted that the number of DB schemes within the UK would fall from 5,588 in 2017 to around 1,000 by 2042. In addition, the number of members within DB schemes in the UK would fall from 10.5 million to three million over the same period. Similar dramatic decreases were predicted over this time period, too, in DB scheme assets (£1.5 trillion to £700 billion) and solvency deficit (£800 billion to £200 billion).

"We've seen some movement, but this will accelerate over the next decade," says TPT Retirement Services head of direct distribution Adrian Cooper. "The same patterns have been apparent in Australia and the Netherlands. The same conditions for acceleration are present in the UK."

A flurry of reports has also been released in the last year, signalling an acknowledgment of the shift. In 2017, the government launched a green paper on the subject, a move that is still currently in consultation. This was followed in March by the launch of a white paper from the Department for Work and Pensions (DWP), outlining stiffer measures from The Pensions Regulator for schemes not taking proper care of their members. The same month saw an announcement of a consultation this year on DB schemes and consolidation, with an aim to put into place a 'legislative regime' for schemes looking to go down this route.

The beginning of everything

These different reports and white papers, however, are not the source for current shift in the landscape, but a symptom of it. The truth is that many DB schemes are struggling to find and maintain the returns needed to sustain their commitments. One report found that 10.84 million people are in a DB pension scheme in the UK, but nearly three-quarters of these schemes were in deficit. Costs are also ballooning: according to the Pensions and Lifetime Savings Association (PLSA), the mean cost of running a DB scheme between 2015 and 2016 rose by 37 per cent, with smaller schemes hit hardest, with an average increase of 63 per cent. These costs, along with volatility and low-interest rates, reported the PLSA, are key factors in the decisions of many funds to close to new members.

In *DB Taskforce: The Case for Consolidation*, chair Ashok Gupta declared that the current system is not fit for its future commitments. "It is draining resources from employers and putting members' benefits at risk," he wrote. "Employers have spent £120 billion trying to plug deficits over the past decade, £13 billion in the first nine months of last year alone. But schemes with the weakest employers – schemes which hold 42 per cent of all benefit promises of schemes in deficit – have just a 50:50 chance of seeing them paid in full."

Gupta added: "The bringing together of schemes into larger entities, sharing certain functions to benefit from economies of scale and strong governance would have enormous benefits in reducing risk to scheme members, and also for sponsors and the wider economy."

The benefits of consolidation

While consolidation brings risks, there are numerous benefits for DB schemes. In May, Pension Superfund's chief exec Alan Rubenstein said that around £250 billion of DB liabilities could benefit from consolidation, with this figure doubling over the next five years.

Deloitte's DTRB team senior manager Jeff Cunningham says that the main advantage that consolidation brings is a stark reduction in running costs. "From our experience," he says, one of the schemes that moved into Deloitte's consolidation arrangement, the Deloitte Pensions Master Plan, saw its ongoing expenses reduce by 30 per cent. That's significant. If you look across per-member fees, those savings are higher for smaller schemes. And as schemes pay these fees years on year, those savings build up over the lifetime of the plan."

Those savings, says Cooper, come from across the fund's operating costs. He describes two types of savings. The first, he says, are 'tangible' savings, listing actuarial advice, administration, having a professional trustee, appointing covenant assessors, and the provision of legal services. And there are also, he says, 'intangible' savings. "By that, I mean, having a trustee board, and whether those trustees are nominated by the employer. The size of boards is going to reduce and, as the requirements become more onerous, trustees will have to be equipped to handle that. The demand will be too great for many and will drive them to look for other solutions."

It will not be plain sailing for those choosing to consolidate. Cunningham outlines some of the barriers and difficulties in doing so: "One of the first questions to address is the control of the scheme after consolidation – a key potential barrier at the moment with some solutions is the loss of control, i.e. the ability to retain current trustees, or the employer's ability to appoint new trustees. Another consideration is flexibility, particularly about investment strategies and member benefits, and whether these would be retained post-consolidation. There are also factors to consider around advisers, other trustee powers, and so on."

Others concerns that have been outlined are concerns from trustees about upfront costs, particularly among smaller schemes that may find getting funding for such a move to be onerous; a 'misalignment of interests' across schemes and employers spanning different industries and workforce demographics; gaps in the skillsets of trustees; a misalignment of interests between advisers and the schemes; and variations in benefit structure.

Hopes for the future

There is still a lot to be determined and much of what is already known is still vague and subject to change. With luck and hope, some clarity will begin to emerge.

While the government's consultation following its green paper on DB consolidation is still yet to bear fruit, the PLSA have made three recommendations of measures it hopes will be ushered in. These include the provision of an annual report from trustees explaining how they plan to consolidate or why existing arrangements provide best value; new regulation around the process for reshaping scheme benefits; and a legal framework for the creation, authorisation, and supervision of superfunds.

These suggestions have also been echoed by the DB Taskforce, which has said, "It is clear that greater consolidation would have a significant positive impact on the efficiency of DB schemes today."

Saying that it would develop proposals for possible government oversight, the taskforce outlined some of its thoughts and propositions. It recommended the introduction of legislation requiring trustees to demonstrate each year that their schemes are delivering value for money, a provision of clear standards for the reshaping of scheme benefits; and removing barriers for consolidation.

Cunningham offers a further suggestion, saying that a process needs to exist that helps consolidation become more familiar to trustees, particularly those of smaller schemes. He adds: "The aims of the DWP are to build confidence and encourage solutions. I think it has to recognise that there are solutions in the market that already work and are providing benefits to employers and schemes under current legislation. Any accreditation must consider the successes that have already been achieved."

The real world may ultimately intrude, however, and Cooper acknowledges that while DB consolidation needs to be formalised quickly, there are many clouds on the horizon for this government. At present, the May government is looking to deliver on a Brexit challenge that seems so far to have eluded them. "We'd like to see change being delivered fairly quickly," Cooper says, acknowledging the realpolitik of current times "but with other demands such as Brexit, it may not happen as quickly as we like."

Written by Pete Carvill, a freelance journalist

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