"… Many pension schemes benefit from using a defined benefit master trust *[and]* government wants to do more to help encourage existing forms of consolidation as it recognises the benefits it can bring in reducing scheme costs per member, enabling more effective investment strategies and improving governance."

Public consultation, *Consolidation of Defined Benefit Pension Schemes*, Department for Work and Pensions, December 2018

More for less: Lower costs and improved governance

Paul Yates explains why now is the time for DB consolidation and how to make it happen

The costs of running a defined benefit (DB) pension scheme can be significantly reduced by consolidating into a larger pension scheme. DB master trusts can reduce costs by as much as a third.

However multi-employer schemes have been around in the pensions industry for a long time. So why haven't more schemes consolidated in the past, and why should they now?

Now is the time

The December 2018 consultation by the Department for Work and Pensions confirmed government support for DB master trusts and the benefits they can bring.

In other areas of the pensions industry, The Pensions Regulator wants to accelerate the consolidation of small defined contribution (DC) schemes, following research that revealed the governance in small DB and DC schemes tended to be poor.

Reduced costs and improved governance bring benefits to members, trustees and employers alike. With government backing and regulatory desire for better-run schemes that are more efficient, now is the time for employers and trustees to analyse how consolidation can benefit their DB scheme.

A solution for the majority

Much focus has recently been given to other potential forms of consolidation such as superfunds.

The idea of a superfund is to separate the employer from a pension scheme and have security provided by a capital buffer. The cost of doing this is expected to be lower than buying out benefits with an insurance company.

However, with total UK pension scheme buyout deficits estimated to be around £600 billion, few UK schemes will be in a position to buyout or transfer to a superfund over the short or medium term.

DB master trusts do not require scheme funding to be improved in order to access the benefits they bring. They are therefore a realistic and compelling solution that can be implemented for the majority of schemes in the UK.

Barriers falling away

Transferring to a multi-employer scheme would historically have meant a loss of control for the employer and existing trustees.

However, employers are now able to choose a consolidator where they can retain their existing scheme's trustees on transferring in.

By retaining control, schemes avoid the risk of a 'black box' solution for investment, funding or governance which may not be ideally suited to a scheme's individual situation – and a key barrier to consolidation falls away.

Fit for purpose

Another reason why employers have been reluctant to consolidate in the past, concerns legacy issues with some older schemes.

Multi-employer pension schemes have historically been associated with problems such as orphan liabilities. This is where the sections of a multi-employer scheme are not properly segregated, and if one employer fails their section's deficit becomes the responsibility of other sections' employers.

Older schemes will also sometimes have long and complex rules, amended

many times over many years, potentially leading to uncertainty around interpretation.

Employers can now choose a consolidator scheme designed 'from the ground up' to be fit for purpose, with concise and clearly written rules. This means trustees and their legal advisers can quickly get comfortable that the scheme is properly segregated and suitable for receiving assets and liabilities from different employers.

Making it happen

The good news is that transition is straightforward for a well-designed consolidator.

The first step is a strategic decision to consolidate, and selection of which consolidator to use.

While either the employer or trustees could initiate consolidation, it is generally a more natural fit with how most schemes operate if the employer makes a proposal, and then the trustees consider whether it is appropriate to agree.

Doing a good deed

Trustees need to take legal advice before agreeing to an employer proposal to transfer to a consolidator.

The fundamental questions for trustees are: do they have the power under the scheme rules to agree to a transfer; how member benefits, trustee powers and employer covenant will be maintained; and whether the transfer is reasonable in view of trustees' legal duties and responsibilities.

When this diligence stage is complete and employer and trustees have agreed to proceed, the legal advisers can start drafting deeds. These will establish a new section in the consolidator, and effect the transfer of assets and liabilities into that section.

The legal process is much easier if the consolidator's transfer mechanism exactly replicates member benefits, the balance of powers between the trustees and employer, and the employer covenant. If this is not the case, it is more difficult to conclude the transfer is in the best interests of members and legal review will be more expensive.

Your chosen consolidator may provide template deeds and a legal guide so your lawyers have all the reference information they need to draft the deeds easily to hand.

Making an investment

Support will be needed from an investment adviser to transfer the assets and avoid unnecessary costs on transition.

Consideration of the investment transition should start early, to identify the assets the scheme has and which parties will be involved.

If your chosen consolidator offers flexibility around investments, you may wish to review the potentially wider range and lower cost investments the consolidator can offer, to make sure you get full benefit from the transition.

Transition of services

The consolidator's actuaries and administrators will need to receive details of the scheme and its membership.

Trustees will want to be sure the transition will be handled by an experienced team, and understand the key stages of the installation process.

Your consolidator may be willing to carry out the transition for free.

Keeping on track

As a number of parties are involved in the process, good project management will help keep things on track.

As soon as a decision to consolidate is made, a plan can be put into place and appropriate reporting lines agreed.

Your consolidator may be willing to project manage the transition at no cost.

Making the transfer

When preparatory work for the legal, investment and data transfer workstreams is complete, the transfer can proceed.

The mechanism is likely to be a bulk transfer without member consent. This requires actuarial certification, which should be straightforward assuming your consolidator preserves member benefits, trustee powers and the employer covenant.

There is a statutory requirement to notify members of the transfer within a specific timeframe. Communications will also need to notify of any change in administrators, and contact details for enquiries.

Transfer complete

When the transfer has happened, there are requirements to notify various regulatory bodies, including the transfer being a notifiable event that The Pensions Regulator will need to be informed of.

A good transition will have been seamless from a member perspective, with good service levels maintained throughout.

Your adviser should have a year one plan for meeting statutory requirements for the new section and moving to business as usual. Although, 'as usual' will now be at lower cost than when the scheme was standalone.

Time to get started!

The Deloitte Pensions Master Plan is a new fit for purpose consolidator of DB schemes.

It allows schemes to benefit from economies of scale while retaining control – including keeping your existing trustees, legal advisers, and full control over investments.

The Master Plan won the *Pensions Age* 2019 Innovation Award.

You can find out more at www.dpmp.co.uk.

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In association with Deloitte.