Spotlight on Pensions
PRESENTS
Le Grand View

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DB scheme consolidation: a subject for trustees' judgement

For the past two decades, the movement to reduce the number of individual employer-sponsored workplace pension schemes has been gathering pace, with The Pensions Regulator (TPR) as a strong proponent.

In their 2018 white paper "Consolidation of Defined Benefit Pension Schemes", the DWP raised the pressure on smaller DB schemes, even putting forward a possible design for a "superfund" where they could consolidate with other, unconnected, schemes. This (balanced) white paper is part of a wider review of the DB scheme universe, the results of which are expected to feed into a new Pensions Bill.

The starting premise is that consolidation is a Good Thing. That leads to implied, and increasingly overt, criticism of trustees who have not yet embraced it. But of course life is not that simple, and criticism of trustees on this issue unfairly fails to acknowledge their overriding legal duty to take the broad view of what is best for their scheme's beneficiaries.

"The DB Problem"

Before considering possible solutions, we need to identify the problem they are tying to solve. It is not sufficient to criticise the DB sector simply because the number of individual schemes is greater than in most other countries: if existing schemes are to take on the upheaval of moving to a new home, there must be a clear benefit as a goal. The white paper acknowledges this in its discussion of superfunds, stating in several places that schemes should only move to a superfund where there is a clear benefit to its members in doing so.

The DWP starts from the position that the current DB regulatory system is effective. The Ministerial foreword to the 2017 green paper "Security and Sustainability in Defined Benefit Pension Schemes" states: "The vast majority of nearly 6,000 pension schemes are run effectively and we are fortunate to have a robust and flexible system of pension protection in the UK". We should expect nothing less, given the vast number of new regulatory requirements heaped upon schemes and those that run them, over the past two decades.

Notwithstanding this, the Government has identified areas where it feels DB schemes are vulnerable, and for which consolidation is proposed as a possible solution:

- "low funding levels"; despite recent large employer contributions, it is alleged that schemes remain "underfunded" and too reliant upon uncertain employer covenants. This is despite TPR apparently being largely content overall with funding. The proposed superfund model would require employers to provide a funding boost before the scheme was transferred on. Employer covenants would be replaced with a "buffer fund", which once exhausted would leave any underfunded scheme with recourse only to the PPF
- administration and investment inefficiency through smaller schemes being unable to access some investment vehicles and cheaper administrative services. Consolidation into a superfund would create critical mass to give bargaining "clout"
- poor trustee performance, due to smaller schemes having smaller training budgets and having their (non-professional) trustees stretched through having to devote more time to their businesses. Proposed superfunds would be governed by a small number of (professional) trustees
- global risks of employer uncertainty – the more employers there are, the greater the number that could fold. On transfer to a superfund, the sponsoring employer would bow out of the arrangement.

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Asleep at the wheel?

To read these criticisms, one might conclude that all those running schemes have been negligent in their posts. That is not the case. Trustees have on a measured, individual scheme basis, been diligently pursuing new ways of improving their performance for the benefit of their members and the sponsoring employer. Examples include:

- use of shared administration services
- asset pooling
- use of fiduciary management
- trustee training and the appointment of professional trustees.

These initiatives are yielding real benefits, on a scheme-by-scheme basis, demonstrating that trustees are doing their job conscientiously.

Is "shared" necessarily "better"?

The arguments for consolidation into some form of megastructure ignore one of the key strengths of the current fragmented system – the relationship between trustees, employers and members. This is particularly important with DB, where trustees and employer are relied upon to provide benefits that have been defined in the context of that specific group of employee members. Whilst some commentators focus on the potential conflicts that can result from such a close relationship, others recognise benefits. The relationship allows for a more personalised (often paternalistic) approach with greater understanding of each party. It also fits with survey results that consistently show that DB scheme members trust their sponsoring employers the most out of all the parties involved in providing their pensions. Shifting responsibility for the scheme to a global, commercially-run structure where those close connections are severed runs contrary to that.

Balance

There are undoubtedly benefits from consolidation. However, it must be applied intelligently. Many trustee boards already consider the issues conscientiously and, where appropriate, utilise consolidation options according to the circumstances of their particular scheme.

The consolidation debate however is in danger of sinking to an assessment solely of simple short-term costs. In the DB world that fails to recognise the wider real benefits that can flow from the individual employer-linked scheme.

The white paper discusses the idea that trustees be required actively to consider and report on a prescribed regular basis whether their scheme best serves its members by remaining independent. Given the clear subtext that independence is necessarily the inferior option, the pressure to consolidate would be strong. Any statutory definition for such a test would also likely be too simplistic.

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Trustees have a broad duty to consider the best for their beneficiaries. As one of the fundamental strengths of the system, it should not be overridden by legislative constraints that artificially narrow trustees' focus. Whether or not the new requirement for a specific regular test comes about, the pressure on trustees to follow the consolidation route is only going to increase. Given that the benefits of consolidation – although clear in some respects – are not universal, a proper balance should be maintained. Trustees should continue to be given the freedom to do their jobs, with the legal system positively supporting their duty to use their judgement to assess what is best for their scheme's beneficiaries.

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