



CAPITAL CRANFIELD TRUSTEES

THE BALANCED VIEW

Professional Sole Trustees — The way forward for Pension Scheme Governance?



Bob Bridges suggests how the strain of employer led pensions can be eased

*'Outsourcing'
the Trustee—
the future
model?*

This may seem a rather strange question as, we are just entering an era of MNT elections, and opt outs are no longer possible. However, despite the new regulations, at Capital Cranfield we are experiencing increasing interest in the concept of 'outsourcing' the trustee function. So could this be the future model? It is not a completely new idea. In the past a sole corporate trustee has been appointed after the insolvency of the sponsoring employer, when potential employer and employee representatives are no longer available. Insolvency practitioners appointed a corporate trustee to wind-up the scheme – for final salary schemes the Pensions Regulator has now taken on this responsibility, where it deems it appropriate.

For ongoing schemes the 'opt out' choice has sometimes resulted in a 'sole trustee' appointment, typically for smaller pension schemes, but from October this year the 'opt out' will no longer be an option. If they have not already done so, all trustee groups are now developing a process for implementing the MNT Regulations. This will result in many more trustees nominated by the members. Overall this must be a good thing and should result in better governance, particularly given the sound framework of Codes of Practice introduced by tPR over the past two years.

But the system is not perfect and the insistence on at least a third of trustees being member nominated will not, on its own, improve governance. The Trustee Knowledge and Understanding (TKU) requirements, with tPR's training availability on live modules providing excellent support, are now an integral part of trusteeship. The existence of TKU may put off a number of potentially excellent trustees from putting themselves forward. Running pension schemes is complex and high level of knowledge is crucial. I have always maintained that trustee boards as a whole should possess the necessary expertise, not necessarily every individual, but a broad level of knowledge and understanding for all is clearly essential, and indeed a requirement under trust law.

*Managing conflicts of interest
my be preferable
to avoidance*

Complex and costly

Managing a pension scheme trust is time consuming and expensive. The responsibility can worry trustees and there are clearly risks for them. Conflicts of interest can and do arise, although I would always rather manage conflicts, not try to avoid them altogether. In particular, having company directors on trustee boards brings so much to the table that their presence should be



encouraged, not denied because of potential conflicts. A more difficult issue is the need for trustees to fully understand financial information about the company when this is often organisation sensitive and sometimes price sensitive. This can put MNTs in a very difficult position.

The typically quarterly - but often less frequent - trustee meeting cycle can result in a slow decision making process. On investment matters, in particular, this can be damaging. Investment decisions need to be understood and discussed fully, then often implemented quickly. Delay can mean that the moment is lost, as market opportunities do not wait for the next trustees meeting.

Provided that adequate resources are available the governance model resulting from the MNT Regulations is the optimum. It brings member involvement and full accountability. The Codes of Practice framework, and recognition of taking a proportionate approach introduced by tPR, provides a sound foundation. But the whole edifice is costly to implement - both in time and resources. This is one of the reasons for final salary schemes in the private sector heading for extinction (apart from a small number of mega schemes).

The Professional Sole Trustee will have the necessary experience and will recruit suitably qualified people

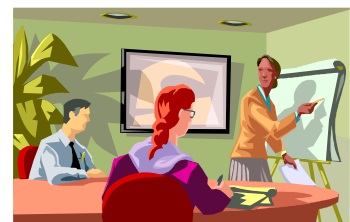
Is there a better way?

Many functions can and should be delegated or outsourced if internal resources are not adequate, but this can also be costly. So is there a better model? If we ignore the requirements of the MNT Regulations for the moment, the responsibilities could be handed to an independent Corporate Trustee as full time 'sole trustee'. This could be a very attractive alternative. The sole trustee will have the necessary expertise and will recruit suitably qualified people. Many functions can be standardised with the amount of detail kept at an appropriate level. This should bring a high level of governance at an affordable cost. Day to day decisions can be implemented without waiting for quarterly meetings. Internal expertise will reduce to the need for external advice but not take the place of external independent advisers and service providers completely. However, introducing some standardisation to the process will bring significant cost savings.

tion to the process will bring significant cost savings.

It is essential to gain an independent insight into the strength of employer covenant, and the use of external accounting firms to carry out the review may become a realistic option where the cost/benefit trade off would make this not an option for small schemes operating in the traditional manner. So there would seem to be a number of advantages to this model but there are drawbacks too.

The corporate trustee is detached from the pension scheme plan sponsor and the members. This gap has to be bridged as understanding the company is crucial. This means not only the financial covenant but also its values and priorities. Links need to be established ideally with member representatives, as well as with company directors. A committee constructed along the lines of a trustee board can work well. This need not duplicate effort since it is a reporting/reviewing body not an operational and decision making one.



Problems with “orphaned” schemes

Over the years ahead, ongoing final salary pension schemes with active members accruing benefits will become increasingly rare. There will be many such schemes where there are few or no current employees with accrued benefits, or directors who were around when the schemes were active. There will still, however, be significant assets accumulated to provide benefits for retired and deferred members. There is likely to be declining interest within the company to support the traditional trustee model. Whilst large such schemes may choose to buy out benefits, or transfer the liabilities to a third party, the ‘sole trustee’ model could become increasingly attractive for smaller arrangements.

The traditional trustee model, improved through the tPR codes of practice and the new requirements for MNTs is an ideal framework. This assumes adequate resources can be brought to the table. Where this is not possible or affordable the ‘sole trustee’ approach is in theory a viable alternative.

Can it be done within the letter and the spirit of the legislation?

A big question remains however – can the ‘sole trustee’ approach be implemented under the legislation? It is clear from the regulations that corporate trustees already in place before the effective date of the legislation can continue; it is not clear that new arrangements can be put in place on this basis. Master Trusts covering un-associated employers have also been established, and this also delivers sound governance with economies of scale under one trustee board. Existing trustees must run the MNT process. Members must be given the opportunity to seek appointment, at least active and retired members. Once a scheme no longer has any active members, it would seem difficult to imagine that a process which excluded deferred members would be acceptable. Provided that a democratic process is conducted that leads to the appointment of a sole corporate trustee then perhaps any barriers to this being implemented could be overcome. To be consistent with at least the spirit of the legislation this would need to be retested from time to time – the corporate trustee could re-run the MNT process at reasonable intervals.

Many companies moving from final salary pension schemes have switched to defined contribution using Stakeholder or Group Personal Pension arrangements. This contract based pension provision removes the need for trustees, but possibly at the cost of less accountability and weaker governance. This suggests that companies feel that the onerous requirements of running trust based arrangements are unacceptable. If so then the concept of appointing a corporate ‘sole trustee’ is an attractive alternative but only so long as it can be accommodated within both the letter and the spirit of the MNT requirements.



If you would like to discuss any aspect of sole trusteeships contact Shona Goulds

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