

LEGISLATION THREATENS TRUST-BASED PENSION PLANS

Pensions legislation making its way through Parliament increases the risks and complexity of pension schemes administered via a trust, rather than a contract. The new burdens and responsibilities to be shouldered by trustees are particularly onerous.

The Pensions Bill going through the House of Lords removes the right of companies to opt out of having worker-appointed trustees in trust-administered defined benefit and defined contribution schemes. It also raises the minimum percentage of worker representatives on the trustee board from 30% to 50%.

The Pensions Bill also seeks to increase the duties of trustees and harden their personal liability where they neglect these duties. This raises a number of issues for companies as to whether they are better off adopting a contract-based pension scheme for their company or a trust-based scheme.

According to Nick Burns, group managing director at consultants and actuaries firm PIFC Consulting, there are four categories of pension scheme in the UK:

- (1) Final salary schemes, or defined benefit (DB) schemes.
- (2) Money purchase schemes, or defined contribution (DC) schemes.
- (3) Group personal pensions (GPPs), which are DC schemes.
- (4) Stakeholder pensions, which are also DC.

It is important to realise that the trust versus contract debate is not the same as the DB versus DC debate. Money purchase schemes, for example, are DC schemes, but are generally trust

based, as are final salary schemes, which are DB schemes. GPP schemes are DC schemes, but are always contract based as the provider has a direct contract with each employee.

Consider the fundamentals

In the light of the changes proposed by the Pensions Bill – and before they broach the subject of trust versus contract – companies would do well to revisit the basic question of why it is that they want to have a company pension. Burns offers three key motives:

- (1) Pension schemes are seen as good employee recruitment, retention, loyalty and motivation vehicles.
- (2) The company wishes to be an “employer of choice” in its sector and wants its reward and benefits package to be upper-quartile.
- (3) The paternalistic approach, where the company wishes to “do the right thing” by its staff and secure them a comfortable life in their old age.

Practical implications

Once a company is clear on its business objectives in having a fund, it can then approach the trust versus contract debate and see how each structure plays against those objectives. Take two extreme views. On the one hand is the company that is offering a pension scheme because the competition has one, but which wants to spend as little as possible. On the other is the company that is prepared to offer a quality pension to its staff and simply wants to find the right vehicle for it.

Minimalist option

The expense and complexity associated with a trust-based approach rules it out immediately. Contract is infinitely simpler, requires no trustees or worker training and is clearly the low-cost option. The next step is to choose between a GPP scheme or a stakeholder scheme, both being contract based. This is a bit like choosing between two different flavours of butter. Basically, nothing terribly serious hangs thereby.

Paternalistic approach

Here there is a serious decision to be made between trust-based schemes and contract-based schemes. However, while an explanation of this could be made tremendously complex, there is a way of simplifying things by means of an analogy. Imagine the employer has two rooms he can choose to enter: one is headed trust-based schemes; the other contract-based schemes.

In our analogy, the room housing the trust-based scheme will be filled with elephant traps, shadowy threats of insolvency, lawyers and regulators. Employers that enter this room with the most benevolent of motives will find themselves enmeshed in heavily regulated processes. Worker trustees will have to be found, protected by insurance against possible future litigation and trained part-time by expensive consultants to understand pension trust law.

By way of contrast, the room headed contract-based schemes will be warm, well lit, comfortable and unthreatening, with no baggage, and the employer’s objectives will be

achieved with no fuss. The word trustee will not be uttered and the regulation of the scheme will be under normal contract law. If the question, ‘Which room would you choose?’, seems superfluous, the point of the analogy is made.

Contract schemes

Employers that choose the contract option will find they have saved a substantial sum, of the order of say £50,000, which they would have had to spend training trustees and indemnifying them. They could choose to keep this money. But a better option would be to spend an equivalent sum educating their entire workforce on the benefits of the contract scheme the company is setting up for them. “It makes sense to spend on education, not on regulation,” Burns concludes.

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Useful links

- For a full guide to the duties and responsibilities facing trustees, go to www.opra.gov.uk/pdf/trusteeguide.pdf
- NAPF’s brochure, *Defined contribution pension arrangements: Choosing the right one for your staff*, can be found at www.napf.co.uk
- PIFC’s Contract v Trust document can be found at www.pifc.com