Preparing for the rainy day

A RECENT ACT LONDON REGIONAL GROUP HELD A MEETING UNDER THE CHATHAM HOUSE RULE LOOKED AT THE CHALLENGES FACING DEFINED CONTRIBUTION PENSIONS WITH A WIDE RANGING DISCUSSION ON THE KEY PENSION ISSUES CONCERNING TREASURERS.

Defined contribution pension schemes have one key point of difference from defined benefit schemes which treasurers, and indeed everyone else involved, should constantly bear in mind. While DB schemes promise to pay out the beneficiaries agreed pensions, those in charge of DC schemes are being entrusted with people's pension money and employees trust them to eventually provide a satisfactory return.

Most DC schemes offer a choice of lifestyle or freestyle funds. A lifestyle fund, the most common instrument, is set up to automatically derisk as the individual approaches retirement. Freestyle funds leave the choice of funds up to the individual. Most DC employees are happy to leave the responsibility of choosing funds with the employer. But what about those who opt for the freestyle solution? How much choice can the employer offer in terms of variety of funds and, perhaps more importantly, how much should the employer warn about the danger of not derisking the individual fund as the employee nears retirement?

The choice of funds can encompasses equities, bonds, income, property, commodities, and absolute returns. But employers have to decide how many funds they should offer employees. This potential choice also raises questions. How much should employers try to educate employees about the risk associated with various types of funds and how does the company keep control of the costs of running a wide variety of funds, especially if the take up for the more exotic is very limited? Many feel that offering a wide choice is not possible and does not offer value for money. A meeting of the ACT London regional group on pensions recently heard that this is where SIPPs (self invested personal pensions) could be used for that handful of individuals who wanted to invest in particular and unusual instruments.

A QUESTION OF COST In effect, in some companies, the costs of DC schemes are subsidised by the DB schemes. The costs of running DC schemes are significant and while it is tempting to think that fund managers can be changed if performance is not satisfactory this is a difficult and expensive process and should only be undertaken after careful thought. As one participant at the meeting put it, unless there are significant funds up for grabs, there is not a long and orderly queue of fund managers waiting at the door.

In summary, those charged with designing DC schemes have to

Last minute deals

Looking at some of the different types of schemes available for pension planning, John Shirley of Westminster Consulting led a discussion on EFURBS. An EFURB, employer finance unapproved retirement benefits scheme, is a way for companies to provide retirement benefits for directors/shareholders and higher paid employees, typically with salaries in excess of £150,000 a year. EFURBS don't have the restrictions of approved and registered pension schemes and so are often used if individuals are approaching retirement and looking to quickly build up a substantial fund. The lack of restrictions means that EFURBS can invest in property or buy shares in the sponsoring company. From the individual perspective an EFURBS pension is treated like any other pension income. The company doesn't get relief against corporation tax for the year it makes the contribution. Instead it receives relief when payments are made from the fund to the beneficiaries. That clearly gives a cashflow disadvantage for the company in terms of the tax relief. However, EFURBS have some neat advantages – such as the ability to make loans to directors in an easier and more efficient manner than if the company tried to provide a loan directly. The loan can be made without tax having to be paid and a commercial rate of interest is paid by the director into the EFURB rather than a third party lender. But care must be taken to ensure the EFURB is properly set up to ensure it doesn't breach HMRC rules.

steer a course between believing one size fits all and offering a wide variety of choice. While treasurers and others involved in running DC schemes are aware of these difficulties and limitations, companies say that surveys of their members show they are generally happy with the choice and the way the scheme is run.

In terms of regulation, government and regulators – including the Pensions Regulator, and its predecessor body the Occupational Pensions Regulatory Authority (OPRA) – have both spent more time worrying about DB schemes than DC schemes, but that is now changing. For instance in February 2010 the Investment Governance Group issued a consultation paper on the Investment governance of DC schemes setting out a framework that provided practical guidance to help those involved – trustees, providers, employers and advisers – to increase the transparency and accountability and so to improve decision making. These moves are going to become even more important as firms and companies of all sizes face the task of auto enrolment in 2012. At present 1.5 million companies do not have a pension scheme to offer their employees.

CAREFUL MANAGEMENT GETS THE RIGHT RESULT The main task for regulators is to ensure that adequate systems are in place so that when individuals and companies start putting money into DC schemes they can be reasonably certain that the pension they were expecting will be there when the time comes. This requires the scheme to be well run, which includes having appropriate investment policies and careful administration.

A crucial task for sponsoring companies is record keeping and it is clear that this is an area where even the best run and best intentioned companies can make terrible errors – such as inadvertently destroying pension records – which can cost them dear in time and money to recreate. Questions from the meeting made it clear that the exact role of companies in maintaining and constructing records is full of grey areas.

Perhaps slightly flippantly it was suggested at the meeting that those running DB schemes needed very little detail to calculate the correct pension – little more the final salary of an individual and the date they joined the company. For those running DC schemes it more complicated, with the need to know details such as what funds the individual had invested in and when.

The responsibility for getting this right inevitably falls on the trustees, so perhaps it was inevitable that the meeting turned to discuss whether treasurers should act as trustees. Many who attended were adamant that treasurers who are trustees are at risk of being personally sued if events do go wrong and cause too many conflicts of interest. For instance, as a trustee you have a duty to share information with fellow trustees on a timely basis but as a treasurer you may have access to company information or plans, such as an acquisition or takeover, which you are not able to disclose because of commercial confidentiality. Some treasurers said they were comfortable attending trustee meetings and offering information and advice when asked, without formally being an adviser. Others suggested that if the company did require financial professionals to be trustees it was advisable to select financial officers from business units or subsidiaries. They had the expertise that was required but because they were removed from the head office/corporate function there was less chance of conflict arising from access to sensitive commercial data. Like much else on pensions, the debate over treasurers as trustees will rage for some time to come.

UNLESS THERE ARE SIGNIFICANT FUNDS UP FOR GRABS, THERE IS NOT A LONG AND ORDERLY QUEUE OF FUND MANAGERS AT THE DOOR.

Who's who

The evening was chaired by Fiona Crisp of Crisp Consulting and the speakers who introduced the topics were Roger Burge formerly group treasurer of Cable & Wireless and now director of treasury and corporate finance at communications infrastructure company Arqiva, John Shirley of Westminster Consulting and June Mulroy, director of delivery, at the Pensions Regulator.

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