Plus π

news and views

Winter 2008/2009

THE CRUNCH BENEATH YOUR FEET

As businesses increasingly feel the impact of recession, it is not just the winter snow that could be crunching beneath our feet.

Already the subject of high scrutiny, pensions will, more than ever before, be at risk of change. With the pressure on businesses to tighten their belts, trustees and pensions professionals should be more aware than ever of the need to monitor the risks which face pension schemes.

With such change upon us, and more and more schemes likely to go into PPF assessment or wind up, we are pleased to welcome Angela Hills to our ranks. Angela has worked in the area of wind ups for over 23 years and has been involved with the PPF since its inception in 2004.

Our theme for this issue centres on the current uncertain economic conditions and the issues it raises as well as the growing focus on DC governance.

Anne Lechley, Editor

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Pi+ Events

Contact Us

Pi+ Events

Forthcoming Pi+ Seminar dates for your diaries are as follows:

- 5 February 2009 (Getting the best from your investment advisers)
- 26 March 2009 (Topic to be confirmed)
- 21 May 2009 (Topic to be confirmed)

Seminars are held at the Chamber of Shipping, Carthusian Court, 12 Carthusian Street, London EC1M 6EZ. We welcome you to join us at 8.45am for coffee and breakfast before the participative session which runs to a tight 1 ½ hours timeframe, finishing at 10.45am.

If you would like to attend and/or wish to receive advance notice of the subjects to be covered in future seminars, please contact Janet Symes.

"Professionalism and independence in occupational pension and reward consulting"

Let's Play.... Risk

by Morag Williams

Driven by the Code of Practice on Internal controls produced by the Pensions Regulator and fuelled by the efforts of myriad consultants, risk is the new key word.

The important question is: How do we achieve an approach to risk that is practical rather than purely theoretical?

Pi knows that producing a generic risk matrix for an occupational pension scheme is not enough. The skill lies in making that risk matrix relevant to the specific scheme and ensuring that the trustees own, value, control and review their own risks. Pi believes that there are three elements to achieving that aim.

A game of strategy

The first is to ensure that the risk review is appropriate. The trustees should be clear on what their priorities are for the scheme:

- Is the scheme defined benefit or defined contribution?
- Are they aiming for the lowest running costs or for the highest quality?
- Are they looking for absolute certainty in returns or wanting to maximise returns with low risk?
- Do they have a fully mature scheme with very few actives (or even none at all) or is it still open to new members and core to the recruitment process of the employer?
- Are they on a path to buy out or radically opposed to following that route?
- Are their services provided by one provider or are they managing a number of advisers and providers?

There needs to be an understanding of all these issues for trustees to determine the priorities of their review. It will also allow them to determine the appropriate level of controls for the risks that they face. There may be various levels of control that will involve differing levels of cost and resource and it is for the trustees to determine which level is appropriate to their scheme.

No room for 'make believe'

Risk review should never lose sight of the aim. Controls that are ineffective serve no purpose.

Trustees need to be clear that they are not creating the "emperor's new clothes", a framework that relies on checklists and reporting that fails to be rooted in the reality of the scheme administration and processes.

Only with understanding can trustees be sure that the controls that have been put in place meet their aims and control risk. It is insufficient to merely state that the use of a specialist adviser is the control for a particular risk.

Taking Administration as an example ...

The recent consultation document from the Pensions Regulator on Record Keeping may cause a few wry smiles but the risks to schemes that arise from poor record keeping are many.

For years trustees have relied on the "nice" people that do their administration and said "the data is good". In reality they may have never known whether it was good or bad. Without that knowledge the risks of increased costs and unknown liabilities are high.

Data cleansing that identifies inconsistencies may offer a partial solution. However it will not identify errors which can arise, for example, in the calculation of early retirement from deferred status and the application of pension increases; areas which could create immense problems for trustees at a future date.

Often, the stringent processes of wind up or Pension Protection Fund (PPF) assessment will flush out issues which have been building for a long time, issues that could have been controlled by the proper storage of scheme records and other material.

A game of 'What if?'

Sometimes risks that can impact on a scheme are completely outside the control of the trustees. When this is the case, a practical approach will question what the risk to the scheme is, whether it can be reduced, and if not, whether the impact of that risk can be reduced through repositioning the scheme. It may also be worth having a strategy in place!

A workshop to talk through (and document) possible scenarios can be a useful exercise for trustees. This way, if they happen in real life, the issues and options have already been thrashed out with advisers facilitating speedy, well considered, responsive action. These workshops can also be a robust learning tool for all the trustees and especially for those who may have an ongoing conflict of interest.

Articulate!

A risk matrix is of no use if it is worded in such a way that the actual risk and control cannot be understood because the complexity of the words obscures the meaning. For trustees to own the risks they must not feel detached from the text. This important document that clarifies the risks and their controls must be readily accessible, alongside key control documents, so that trustees and other parties can easily review them.

Win-win!

A practical approach to risk means an approach that is appropriate, meets the aims of the trustees and is accessible by all. Trustees that have effective controls in place can be reassured that they are achieving good standards of governance in their role and can be clear that they are fulfilling their key role of providing the correct benefits to the correct people at the correct time. After all, that is what being a trustee is about!

Morag joined Pi in 2007, bringing her long and varied experience within the pensions industry with her. Initially, she worked for the Prudential Group Pensions Department in the 1970s, then with Noble Lowndes as a technical consultant. Moving to work' in house' in 1990, Morag progressed from assistant pension manager to pension manager. Finding herself back in consultancy in 2001, following the outsourcing of the administration function, Morag has since managed and been involved with many projects including procurement of all advisers, administration reviews, strategic consultancy and trustee training.

Is It A Wind Up?

by Angela Hills

Acceptance into PPF assessment is often greeted with a sigh of relief. But far from being the end of the story, it is just the beginning.

The key to reaching a successful conclusion to the PPF Assessment Period is good project management and regular communication between Trustees, advisers and the PPF.

The PPF's main aim is to ascertain whether scheme assets are sufficient to provide PPF levels of compensation on buy out. If not, the PPF will step in, but if they are, the scheme will proceed to wind up outside the PPF.

If it turns out that it is the latter, timing will be a main issue as it is important not to worsen the purchasing power of assets. Getting a full picture of the scheme's position to determine the likely outcome as quickly and efficiently as possible is therefore essential.

Understanding the process and the likely issues can help immensely with arriving at a satisfactory result. So what are they?

- Reviewing the governing documents – the first hurdle is making sure that you have a full set of trust documentation. Any changes that have improved benefits in the last three years, which may have reduced the scheme's funding position, will need to be removed.
- Understanding the benefit profile – you will need to answer questions such as 'What is the scheme's normal pension age?' Are there any special benefit categories?' and 'Has equalisation been applied?'. As compensation is based on a member's Normal Pension Age, it is vital to establish the position for each member.
- Knowing your members – you will need to know who they are, make reasonable efforts to locate them all and check that their benefits have been applied correctly.
- Investment strategy – in case you need to wind up independently, you will need to make sure that the scheme's assetts are invested appropriately with the end game in sight
- Getting the right advisers – advisers with the right experience will save time and cost as all parties will understand the common goal and what is required of them.

Of course, each scheme and the issues it faces are different. However, in all cases, an experienced independent trustee can undoubtedly help take away some of the pain of this complicated process .... whether it's a wind up or not!

Angela has over 27 years experience in occupational pension scheme management, working for Mercer during this time in a variety of administrative and management roles. Before joining Pi Consulting Angela was the Group Manager of Mercer's Wind-up team. She was also a member of their "Best Practice Group", as well as being on their Steering Group for scheme terminations. Angela has an excellent knowledge of pension scheme management, with particular expertise embracing insolvency and the PPF. In addition Angela was a member of one of the Government's "Speeding up Process" working parties and is a member of the industry wide initiative for raising standards of pension administration.

All Sold Out

by Tim Evans

With hard times ahead, and deficits becoming larger following the major falls in investment values, the option of buying out benefits with an insurer may seem more attractive than ever before.

Early last year, the combination of relatively high equity markets and bond yields together with the entry of a number of new competitors in the buy out market encouraged the thought that the gap between buy out costs and a scheme's available assets may have narrowed sufficiently to make this option feasible.

However, even before the events of late September, my own experience of finding an insurer prepared to buy out the liabilities of a small scheme did not bear out this theory. Through investigations on behalf of one client, I eventually managed to obtain a quote from the insurer organisation already responsible for administering the scheme and a further quote from one of the market favourites. The latter, although better than the first quote, stated a cost nearly double the value of the existing assets!

And now?

With lending at a practical standstill and lenders demanding much higher solvency in respect of borrowers before parting with their money, insurers are undoubtedly now finding it difficult to raise additional capital to support this type of business. Coupled with the impact of recent market turmoil on long-term investment return predictions, the availability of buyout quotes has significantly reduced. Undoubtedly, one of the critical factors in obtaining a quote is choosing the right adviser to approach buyout providers.

A longer term strategy

The buy out market may recover, but whether it will ever return to the promising times of early 2008 is yet to be seen. Trustees of smaller schemes who are currently managing the liabilities of an ageing membership may do well to follow a longer-term strategy to achieve their buy out objectives.

Setting a scheme's target funding level to full solvency over a 5 or 10 year period may therefore be a more realistic approach for sponsors, rather than looking to fund an immediate buy out. By harnessing an appropriate investment strategy that allows markets to recover and gradually switches to match those investments typically used by insurers, the buy out of scheme benefits may be managed effectively with reduced costs that are spread out.

With no easy answer, experience tells me that the majority of schemes will carry on as they are for many years to come, despite the increasing regulation and external costs imposed on them!

Tim, who became a Fellow of the Institute of Actuaries in 1976 and is a long-standing member of the Association of Consulting Actuaries, has been in the pensions business for over 40 years. After nine years working with two City insurance companies, he moved on to become a consulting actuary. In his time, he has worked for Harris Graham & Partners (acquired by Wyatt, now Watson Wyatt), William M. Mercer and Reeves Brown Associates Ltd. (acquired by Jardines, now Jardine Lloyd Thompson). In addition to working with Pi, Tim also runs his own actuarial consulting business and is an employer appointed Trustee in his own right.

Transforming DC Governance

by John Oldland

The difference between governance regimes for trust and contract based defined contribution (DC) plans has historically been extreme.

Having previously been solely the province of the FSA, whose principle task is to 'police' providers and concentrate on 'point of sale' regulation, the arrival of the Pensions Act 2004 broadened the governance responsibility for contract based plans by giving the Pensions Regulator (tPR) direct responsibility for 'work place based' pension plans.

Shaping up

After a hiatus of three years, tPR and the FSA jointly published extensive guidance on the governance of Group Personal Pensions (GPPs), a term now recognised as covering all forms of group stakeholder and personal pensions, in November 2007. This initial guidance included:

- good communication
- choosing providers
- the appointment of investment managers
- selecting funds and
- obtaining value for money

Since then, guidance on "Voluntary Engagement" and a DC update, explaining the results of tPR research and how it plans to fulfil its commitments, has emerged along with more developed guidance. This has specifically addressed effective member communications, good practice in member retirement options, making pension fund choices.and included a questions and answer summary to 'bring together some of the key issues'.

The production of such 'voluntary guidance' can leave sponsors in no doubt of tPR's expectations of them.

But as many employers have chosen a GPP arrangement over a trust-based plan to rid themselves of the costly and onerous governance responsibilities that the latter involves, what are the chances of a substantive move to improve the governance of GPPs in 'compliance' with a voluntary code? And in the absence of voluntary compliance, where will that leave the tPR?

The huge expansion of DC pension arrangements as a result of the introduction of "Personal Accounts" and auto enrolment is yet another consideration to be thrown into the mix! The regulators own guidance tells us that only 39% of the working age population are in a private pension – all of whom are potentially new personal accounts members or new entrants to an alternative offered by their employer.

With a statutory duty to observe it is unlikely (some might say impossible!) that tPR can or will walk away from this issue and turn its back on the extensive guidance so far produced. There must be a high probability that the suggested voluntary regime will at some future date become mandatory.

So what does the future hold?

You would be right to wonder how this will affect the current market place for the different DC options available.

For many trust-based arrangements, governance standards will already be in compliance with (and may be ahead of) the new guidance. Nevertheless, trust-based schemes need to remember that a good deal of the guidance applies equally to them. As such, DC scheme trustees need to be aware of and understand the new guidance – which at the very least sets new governance and good practice benchmarks for them.

For GPPs and the like, it is for employers to take the initiative. Some options suggested by tPR for overseeing DC governance requirements are:

- Adviser e.g. IFA, employee benefit consultant
- Employer representatives e.g. HR dept
- Employees
- Management committee
- Trustees of existing occupational pension schemes
- Independent Governance consultant

Of course some organisations already have some monitoring "mechanism" in place. However tPR research also revealed that such arrangements are often informal, not particularly effective and need strengthening.

There is plenty for employer sponsors of GPPs to think about. For any organisation considering their options, with the sway of advantage that GPPs currently have, perhaps about to be eroded, maybe it's best to sit on the fence for the next year or so!

John Oldland is Pi's Executive Chairman, with primary responsibility for all consultancy and trustee services. Over 30 years exposure to the pensions industry, working for Noble Lowndes/ Sedgwick Noble Lowndes/Mercer has given him extensive consultancy, trusteeship, project management and senior management experience, with responsibilities including service delivery; client relationships; advice and secretariat services to trustees and strategic advice to employers.

Contact Details

If you would like further information on any of Pi's services or are an experienced pensions professional who is interested in joining the Pi Team, please contact Anne Lechley or Sandra Afonso in the first instance using the details shown below:

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