

In association with

**CHARLES
STANLEY**
Fiduciary Management



Small schemes roundtable

MODERATOR:

➤ Chris Haywood, Senior Portfolio Manager, Charles Stanley

PANEL:

- Stefano Carnevale, Senior Investment Consultant, Quantum Advisory
- John Flynn, Co-chair, Association of Member Nominated Trustees (AMNT)
- Paul Francis, Principal Investment Consultant, Quantum Advisory
- Jerry Gandhi, Independent Trustee, CAP Services
- Bob Hymas, Trustee Executive, BESTrustees
- Clare James, Client Director, Zedra
- Barnaby Low, Fiduciary Portfolio Manager, Charles Stanley
- Lisa Purdy, Professional Trustee, Capital Cranfield
- Pauline Sibbit, Trustee Director, Trustee Corporation



Paving the way for smaller schemes

➤ From consolidation pressures to navigating endgame options, our panel reflects on the challenging environment facing smaller schemes today and into the future

“**S**mall Schemes, Smarter Strategies: Investing for the Final Mile”: This was the title of Charles Stanley’s recent roundtable, which brought together industry experts to discuss investment considerations for smaller schemes as they move towards their chosen endgame. But the conversation delved far deeper than that, covering topics such as the increasing pressure on smaller schemes to

consolidate; the challenges of navigating the increasing number of endgame options available; the asset allocation implications that trustees need to consider along the way; the role fiduciary management (FM) can play in all of this – and much more.

The discussion, hosted in collaboration with Quantum Advisory, opened with a clear statement from BESTrustees professional trustee and

director, Bob Hymas: “There is pressure on smaller schemes – which are not necessarily defined by asset size, but arguably by certain characteristics – to consolidate to manage costs, so there is a challenge to their longevity.”

Running costs are high, he added, while the regulatory and technical burdens on trustees are considerable, “so the concept of run-on for smaller schemes is probably for the very few – therefore, we are having to think about what steps can be taken to address costs”.

In addition, argued Zedra client director, Clare James, the new defined benefit (DB) funding code from The Pensions Regulator (TPR) was driving smaller schemes towards buyout due to the requirements to include significant expense reserves in a run-on scenario.

But while the panel acknowledged the pressure to consolidate, the road to consolidation, highlighted AMNT co-chair, John Flynn, was not an easy one: “Consolidation’s been around for easily 10 years. But in that 10 years, consolidation for smaller schemes has hardly moved an inch. The truth is, smaller schemes need help on consolidation. Buy-in and buyout are one answer, because they can’t afford the scheme, they can’t afford the governance, and the new regime is putting even more pressure on them, but while consolidation pre buy-in and buyout should work – then you could go to a buy-in or buyout – it isn’t easy.”

The attendees went on to consider why smaller scheme consolidation hadn’t progressed to date, with Hymas suggesting that, when schemes were in deficit, sponsors perhaps felt uncomfortable about who they would be negotiating with. “But that has now changed in that there are stronger funding positions, following the gilts

Small schemes roundtable

crisis.” Also, he said, “the market is evolving – there are a variety of methods of consolidation coming to the table, including superfunds, which can be a stepping stone towards an endgame”.

Picking up on the impact of the gilts crisis, James stressed that, while many schemes may have benefited, this isn’t the case across the board: “Whilst a lot of schemes are better funded following the Liz Truss mini-Budget, not all schemes are. And for some small schemes, run-on is therefore being enforced, because you’ve got to be funded up to a certain level before you can go into a consolidator. For these schemes, the only option is going to be run-on, until the scheme is in a strong enough funding position that it can move to a consolidator, or buyout. And getting to a strong funding position will mean squeezing as much as possible out of the assets, within appropriate levels of risk.”

The role of the fiduciary manager

It is here, continued James, that the role of the fiduciary manager (FM) can come into play, particularly given the evolution of FM offerings for smaller schemes: “If you know that you’re going to be investing the assets for a number of years, there is a real case for giving fiduciary management consideration”, she argued. Also, the fact that more fiduciary management solutions are being made available at competitive costs for smaller schemes could represent, she said, “a real game changer in terms of another option where schemes can’t afford to do anything other than run on”.

In addition to the growing availability of FM solutions for small schemes, fiduciary managers are also placing greater focus on helping schemes work towards an endgame solution, commented Capital Cranfield



professional trustee, Lisa Purdy: “Yes, there are more solutions for smaller schemes, but also more help around getting to endgame – partnering with insurers and working together more closely on the steps that need to be taken to buyout; offering more detail in terms of where the scheme actually stands in terms of funding levels on a buyout basis, for example, with technology also becoming a big part of that.”

Differing sponsor views

But while the panel agreed that smaller schemes face similar challenges, with many on an inevitable road to buyout, Trustee Corporation trustee director, Pauline Sibbit, stressed that differences do exist from one sponsor to the next, highlighting that some small (and even bigger) schemes might not actually want to go to buyout, even where they are well placed to do so: “I work with a small scheme, for example, which is a family-owned business, and it’s one of those schemes that is arguably perfect for buyout, but they don’t want to go in that direction. So not every scheme is the same, and it’s important we remember that.”

In response however, professional trustee, Jerry Gandhi, questioned why any employer would have an interest in retaining the DB pension scheme in any shape or form. Exiting it, he argued, makes the most sense.

“Many finance directors (FDs) over the past 10 years have been burdened

by their schemes. And realistically, for smaller schemes, it’s an obstruction to the sponsor doing its business. So the focus must be on a route map to buyout eventually.”

This brought the conversation back to the role that fiduciary management can play here, with Gandhi adding: “I’ve been involved with several small schemes recently and the fiduciary management structure is one of the most functionally economic and most effective routes as it allows the focus on that journey plan from now to full funding on buyout.”

Charles Stanley fiduciary portfolio manager, Barnaby Low, concurred that the fiduciary management model can help to bridge that gap: “We have several schemes, for example, that are in that forced run-on situation, where they wanted to go to buyout, but the cost was too high. That’s where we can come in as fiduciaries. We can help schemes have a balanced discussion around how much risk they can bear at whatever point they are on that journey towards buy-in or buyout – they do need to work with their assets and they can have a low-risk growth portfolio to help them get there gradually. And additionally, with the sort of governance structure around fiduciary, we can be monitoring that daily. We can be looking at buyout pricing, then, if and when buyout pricing comes back into play, we can help them act on it.”

Surplus extraction

The conversation then moved to the hot topic of surplus extraction, and the challenges this presents to trustees, as James explained: “If you’re fully funded on a solvency basis, run-on for surplus extraction is a difficult decision, notwithstanding the new surplus sharing provisions from government. As a trustee, my acid test is, what would I say

In association with

**CHARLES
STANLEY**
Fiduciary Management



Small schemes roundtable



to the members if I'd allowed my scheme to run on, to take more risk, to generate surplus – be it to benefit the sponsor, or be it to grant additional discretionary benefits for members – if something was to go wrong, and I had been in the position where I could have secured all the accrued benefit rights in full? It is a difficult decision facing a trustee.

“And the fact that surplus sharing can be contemplated when a scheme has only reached low dependency funding, which may be lower than buyout, makes the decision more difficult, particularly for a small scheme where things can change rapidly,” she said.

Gandhi added that surplus extraction also presented challenges for FDs: “What FD in their right mind would consider this lightly? Yes, there is upside, but there is big downside risk too and no FD will want to be known for running on a scheme and then the scheme collapsing. And it could happen. Unknown risks are there. So, again, the focus must be around the journey plan.”

And that relates not just to the assets, he added, but to the administration and the record-keeping too: “So there's another opportunity here for the fiduciary manager, with an argument for there being better collaboration between them and the administrator, with a view to achieving a more holistic approach.

“Are there, for example, enough tie-ins between fiduciary managers and administrators to understand whether

we have all the right data and in a good enough shape so we can truly understand the liabilities and work together towards the right asset structure?”

Purdy agreed, while also recognising the role technology can play here: “In the future, there should be much more of a tie-up there with the steps that need to be taken on the road to buyout; and technology plays a part here as well in terms of that journey to buyout – it's a real opportunity for fiduciary managers to take more of a role in that space.”

Low concurred that better collaboration with all parties involved would be beneficial to smooth out the entire journey: “The best we get normally is, say, cashflows every three years, and in between that you'll have transfers out, deaths etc, and we can get a rough indication from the actuary of what the impact of those is, but you don't have that full inflation sensitivity, for example and, even if we're talking about small transfers, they can build up over time and you can quickly find that suddenly, there is a few per cent difference.

“And, particularly when you're in that forced run-on situation, where you're trying to eke out every basis point of return, that can throw you off track. So I definitely think more industry collaboration will help there, as will developments in technology.”

Quantum Advisory senior investment consultant, Stefano Carnevale, agreed: “That's what the funding code is trying to tackle – actuaries generally need to be joined up with investment consultants and fiduciary managers. So it's an area that's being acknowledged by TPR.”

An evolving marketplace

The panel then went on to delve more deeply into how fiduciary management has evolved, with Flynn acknowledging

that, “this side of Covid, fiduciary management seems to be experiencing a re-birth, as it can solve a lot of problems for many pension schemes,” he said.

“For smaller schemes,” he added, “you're almost asking why wouldn't you go to a fiduciary manager? It takes away so much of the burden from the trustees.”

Quantum Advisory principal investment consultant, Paul Francis, highlighted the added benefit of speed of execution that you get under a fiduciary management arrangement compared to a traditional model. He explained: “A lot of the challenges when managing investments are around the timescales for decisions to be made and implemented, thinking about changes in strategy, for example. That speed of execution or implementation that a fiduciary manager can bring has been proven to be beneficial, and it's one of the reasons that fiduciary management is firmly back on the agenda, particularly given some of the movements we've seen in markets over the past few years.

“When you've got a dynamic market with changes happening, you want to be able to react to them, particularly if it's the ability to de-risk; and you need to do it quickly and structure a hedge and get all of that done which, in a traditional model, can take quite a bit of time.”

“Also,” he acknowledged, “the fiduciary solution wasn't readily available in the past to smaller schemes. You had to be of a certain size and it started large. It then came in a bit smaller and I've only been seeing, in the past few years, the really attractive cost solutions for the smaller schemes.”

Alongside the smaller scheme fiduciary management offerings, commented Charles Stanley senior portfolio manager, Chris Haywood, the investment strategies on offer today

Small schemes roundtable

are becoming much more tailored to a scheme's circumstances. "In previous years, when the schemes had a deficit and needed the growth of, say, gilts plus 2-3 per cent, a lot of strategies would have looked reasonably similar from consultants to fiduciary managers. Now, there is a lot more tailoring that needs to go on depending on a scheme's circumstances. If they are looking at a buy-in, it's not as simple as holding gilts and credit. All insurers will price differently. Some will use credit, some won't use credit. So knowing your insurer is really important as well.

"If it's run-on, then what is the ultimate aim? Are you investing for the level of income that you need? Is it growth surplus? Is it purely a trigger for when you do financially reach the point of buy-in or buyout?"

"So, the days of having a streamlined solution that you can apply to your whole client base are, particularly for the smaller end of the market, gone, and the idea of having more bespoke solutions now is more important."

That access to a tailored, bespoke solution that can come from a fiduciary manager has made a big difference, argued James: "For small schemes especially, you can often get a more optimal solution under a fiduciary investment approach than it may be possible to generate under a traditional approach using standard pooled fund building blocks."

Purdy agreed that the landscape



offerings were more bespoke, adding how fiduciary management in the past "was sold on the basis of being about picking managers, about getting you growth, and having a portfolio of 50 different best-in-breed managers. Now, it's about building a bespoke solution that is cost efficient and effective and matches the liabilities of the scheme, which is very different to where it was."

Finally, Haywood highlighted two additional reasons why fiduciary management was back in the spotlight – one being cost reduction and the other improved transparency: "There used to be big solutions with 50-odd managers that were used and a lot of the time you weren't quite sure what was going on underneath the bonnet. Fiduciary management has become a lot more transparent now."

Final thoughts

As the discussion drew to a close, the challenges facing smaller schemes once again came under the spotlight, as well as the importance of giving them support as they navigate the options available. Gandhi commented: "There are lots of challenges for small schemes; and access to data, information, and support is harder for them and proportionately more expensive.

"However, in general, the direction of travel is clear. The endgame strategy must be to exit the scheme from the company books. The quicker they can get structures in place, the better.

"The fiduciary management route is a good one, but it needs to be done with common sense, knowledge and also clarity of focus."

Alongside this, Purdy reiterated the importance of a "holistic view – the assets, the liabilities, and making the journey as efficient as possible, with



technology being a big part of that, as part of the monitoring of it all, and to improve efficiencies".

Flynn and Hymas both emphasised the importance of exploring how smaller schemes might unite to amplify their voices, especially in regulatory discussions; while Low added that, since larger schemes often face similar challenges, there may be valuable lessons they can learn from their smaller counterparts.

Flynn used his closing remarks to also reiterate the importance of not leaving small schemes in the dark: "One of the things we need to resolve is getting the right support for the circa 2,200 small schemes that, at the moment, are just invisible. And if we can agree that fiduciary management is one way forward for them, then that's a better position to where we were before.

"I truthfully think if we don't help them, nobody else is going to."

Finally it was Sibbit who closed the discussion with arguably the most important message of the day: "No small scheme, however you want to define that, is the same; you have to think of them individually, even though you probably want to be getting them all to the same place in the end."

Contact Rebekah Bennett at Charles Stanley Fiduciary Management to learn how their service can support your scheme. E: Rebekah.Bennett@charles-stanley.co.uk T: 020 7149 6922