

# Choosing between trust and contract pensions

What are the characteristics of trust and contract-based DC plans, and what should a company consider when choosing one or the other? Northern Trust's **Aaron Overy** explains

Multinationals considering what sort of DC pension to offer their employees have two options: trust or contract-based. The contract is completely outsourced to an insurance platform with employees having individual contracts with that insurer. With trust-based arrangements, the multinational sets up a board of trustees who arrange to have a range of funds. The debate that multinationals are having is what to offer in the UK. Human resources professionals are tending to prefer contracts, and the pensions departments tend to prefer trust-based plans. The reason for this disagreement is cost; with a contract you do not need to have trustees and, all things being equal in terms of investment options, this additional overhead is sometimes seen by HR teams

to be expensive and not required. The pensions department, however, argues that as a responsible employer you have a moral and probably legal obligation to provide employees with sensible retirement options. To think that you do not have that responsibility under a

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contract is probably wrong. Employers want to ensure behaviour is rational – you should not expect shop floor workers to make the right decisions about their retirement, which is not



their skill. Regulators now expect better governance of defined contribution schemes and sponsors should probably consider whether risks to those members are adequately acknowledged and meet planned objectives. Corporates do not want to get sued if in 20 years' time a member complains they were put into the wrong default fund.

How much information and advice is provided is key. Ironically, those with experience of making investment decisions often do not want to give advice for fear of liability, and so the onus falls onto members. At least with a trust structure you have a board which negotiates and guides, using regulated advice. The trend may be to minimise cost but a trust structure will stand the test of time; will a contract?

The fact is that defined benefit plans are closing at an accelerating pace, and it is now all about ensuring that the options given to members of defined contribution schemes meet the standards required by auto-enrolment

starting in 2012. You need to make sure that the arrangement you offer is sensible as is the range of funds on offer.

Consider, for instance, whether to offer SRI or Shariah funds? Overall the correct level of governance and oversight needs to be maintained.

There are, however, a number of different issues that need to be considered when considering the question of trust vs contract arrangements in the context of pensions reform in 2012. Personal accounts, the default scheme provided by the government, is there to provide a minimum standard where the company does not want to offer its own pension plan. What this will mean for enlightened employers is that DC plans have to be a factor above this minimum. Think of it this way, if personal accounts were the

NHS, the employers' scheme has to be BUPA; with clear blue water between the two. But as part of a benefit package, offering BUPA is good for retention and some large companies might consider using Personal Accounts for temporary employees while workers staying for a year or longer would be offered the BUPA scheme. A statistic recently reported stated that a final salary public sector pension is worth an additional 37 per cent of salary, so if we are looking at corporate DC it is all about achieving a gold plated benefit. This means best in class investment managers with appropriate asset allocation for the long term. ■



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