Insights

For Employers - What to Consider When Choosing a Structure For Your Pension Trustee

Under the Pension Act of 2008 ("The Act"), trustees authorized by the National Pension Regulatory Authority ("NPRA") are responsible for managing both the mandatory Tier 2 schemes and the optional Tier 3 schemes. Although the trustees manage the schemes for the benefit of employees and scheme participants, the choice of what kind of trustee structure the scheme should have, and who the trustees should be, is the responsibility of the company or employer sponsoring the pension scheme. In this paper we outline some of the key considerations that should go into this key decision.

Companies have the choice of either using their own staff as trustees to the Tier 2 or Tier 3 schemes, or selecting a corporate trustee to perform that function

The Trustee's Responsibilities and Capabilities

The pension trustee is responsible for performing three main functions:

a. Managing the investments of the pension scheme with an emphasis on formulating the investment policy and establishing the strategic asset allocation.

b. Appointing and monitoring service providers, in particular the fund managers who are allocated funds to manage subject to trustees' investment guidelines, and custodians who hold the scheme assets, and

c. Managing the pension scheme, specifically performing the administration and operations functions, and meeting the regulatory requirements of the Act, NPRA regulations and NPRA guidelines.

The capabilities required for effectively performing these functions are listed below.

Pension Trustee Function	Capability Required
Investment Management	Investment Policy Formulation
	Strategic Asset Allocation
	Benchmark Design
	Performance Monitoring
Provider Selection	Manager and Custodian Selection
	Manager and Custodian Evaluation
Managing Pension Scheme	Fund Administration
	Regulatory Compliance

The choice of a structure for the trustee of a company's Tier 2 or Tier 3 schemes is mainly determined by which individuals and service providers are best positioned to provide the required capabilities, and what the cost of engaging these individuals and service providers will be.

Choosing a Trust Structure

Anticipating that companies would have different objectives for their Tier 2 and Tier 3 pension schemes, the Act provided significant flexibility in the kinds of trust structures companies may implement, effectively allowing companies to choose from the following four types of structures.

Type	Name	Description
1	**Single Employer With Individual Trustees**	A trustee made up solely of individuals, at least one of whom must be independent of the company
2	**Single Employer With Individual and Corporate Trustee**	A trustee made up of individuals and a licensed corporate trust company
3	**Single Employer With Sole Corporate Trustee**	A trustee made up of a licensed corporate trust company, managing the scheme for the benefit of only the employees of the company
4	**Multiple Employer Master Trust**	A trustee made up of a licensed corporate trust company, managing a master trust in which multiple companies participate

In deciding on a trustee type, the tradeoff is between having the flexibility to adjust the scheme's policy as needed, versus the cost of either developing the required trustee capabilities in-house, or engaging independent investment consultants and fund administrators to provide them

To determine which structure works best for the company, decision makers will need to ask the following questions of their organization:

1. Are the assets in the pension scheme of sufficient size to carry the costs associated with its management?

Although most of the fees charged by service providers to the pension scheme are determined as a percentage of the value of the scheme's assets, there are still some fixed costs that will not vary from scheme to scheme regardless of the schemes size. For small schemes, these fixed costs may represent a larger than warranted portion of the scheme's assets.

2. Does the company have the capabilities required to perform the trustee function in-house?

According to the Act, and in line with global best practices, each trustee should have a minimum required level of knowledge about the regulatory requirements of the Act. In addition, trustees need to be conversant with asset allocation and investment matters to ensure efficient and capable operation of the trust. These knowledge requirements and the need for proper systems to meet the administrative and regulatory standards for the management of a pension scheme are significant.

- If the answers to both question 1 and question 2 are yes, then the company may implement Trustee Type 1 or 2.
- If the answer to question 1 is yes but the answer to question 2 is no, then the company may implement Trustee Type 3.
- If the answer to question 1 is no, then the only real choice for the company is Trustee Type 4.

Benefits And Costs of Each Trustee Type

As shown in the table below, the main benefit for choosing Trustee Type 1 is to have a high degree of control over the operation and management of the pension scheme, and to have the flexibility of making the policy decisions as and when the trustees believe it is in the best interest of the company's employees to do so. This comes at the cost of developing and maintaining the required trustee capabilities in-house. For companies who would like to implement Type 1 but do not want to deal with the additional complexity it requires, we advise that they engage an independent pension or investment

	Single Employer With Individual Trustees (Type 1)	Single Employer With Individual and Corporate Trustee (Type 2)	Single Employer With Sole Corporate Trustee (Type 3)	Multiple Employer Master Trust (Type 4)
Flexibility and Control	High	High	Medium	Low
Cost	High	Medium	Medium	Low
Internal Resources Required	High	Medium	Low	Low
Internal Expertise Required	High	High	Low	Low

consultant to train the individual trustees on areas where they need expertise, and to provide the required investment and fund administration capabilities for the efficient operation of the pension scheme.

For Trustee Type 2, the main benefits are the same as those of Trustee Type 1 – higher control and flexibility. Here again, however, a company would need to develop and maintain some in-house capabilities, at the potential expense of other value-added activities. However, the use of a corporate trustee eliminates the need for the company to develop its own internal administrative and compliance capabilities.

Trustee Type 3 and 4 involve full outsourcing of the trustee function to corporate trustees. This should result in cost savings for the company, particularly in Trustee Type 4, where the assets are being pooled with those from other companies. To achieve these cost savings, the company would have to give up the control and flexibility in the day-to-day execution of the trustee's responsibilities.

Conclusion

The choice of trustee type and the selection of the actual trustees is the single most important function that companies sponsoring Tier 2 and Tier 3 schemes have to perform at the inception of the pension scheme. Once the governance and control structures have been implemented for the establishment of the pension scheme, a proper evaluation of the parameters discussed above should guide companies to determine what the appropriate structure for their pension schemes should be. Companies may then select the actual individual or corporate trustees to manage the scheme.

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