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## Smaller pension schemes struggle most to fill funding deficits

- **Conflicts of interest inevitably more acute**

Smaller defined benefit pension schemes are more likely to be underfunded due, in part, to the stronger conflicts of interest created by their company directors sitting on their trustee board, says Trustee GAAPS, the trustee search and selection firm.

A recent joint study<sup>1</sup> by the Pensions Regulator and the Pension Protection Fund, found that larger schemes tend to have higher funding levels with the weighted average funding levels falling from 113% for schemes with more than 10,000 members to 98% for schemes with under 10,000 members.

The study also finds that smaller schemes tend to have higher insolvency probabilities with a weighted average insolvency probability of 0.77% for schemes with under 10,000 members compared just 0.30% for schemes with more than 10,000 members.

David Johnson, **Consulting Director** at Trustee GAAPS says: “The poorer funding of smaller schemes is only partly explained by the higher profit margins of larger sponsoring companies. The stronger conflicts of interest that exist on the trustee boards at many smaller pension funds plays its role.”

“Small schemes find it hard to catch up with larger schemes in improving their funding levels because of their inability to convince sponsoring companies to make higher contributions.”

“The link between directors and shareholders is much more tightly drawn for smaller companies than larger companies. The smaller the company the more likely it is that directors will have a controlling stake in that company.”

“If you are a director/trustee at a small or medium sized company you may be more reluctant to top up your employees’ pension scheme as that money is coming out of your, or your fellow directors’ pockets.”

David Johnson adds: “The Pensions Regulator is starting to encourage the removal of conflicts of interest but we need to be aware that the problem may get worse over time.”

“Funding levels need to be managed more carefully as they are subject to greater challenges of more volatile market conditions and changing demographic expectations, such as increasing life expectancy.”

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<sup>1</sup> The Purple Book 2007, DB Pensions Universe Risk Profile.

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