PENSIONS AND LIFETIME SAVINGS ASSOCIATION

THE PENSIONS REGULATOR: 21ST CENTURY TRUSTEESHIP AND GOVERNANCE CONSULTATION RESPONSE BY THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION

"GOVERNANCE IS THE FOUNDATION ON WHICH THE SUCCESS OF A PENSION FUND IS BUILT"

9 September 2016

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LIFETIME SAVINGS
ASSOCIATION

INTRODUCTION

We're the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

FOREWORD

In undertaking the programme of work on the 21st Century Trustee, The Pensions Regulator (TPR) has helped to advance the critical debate around the quality of pension fund governance.

TPR's quantitative research on the trustee landscape highlighting schemes' varied records across areas such as trustee knowledge, training and time commitment, has demonstrated the need for better standards, support and scrutiny of trustees.

Our response to the consultation questions is largely supportive of the proposals suggested by TPR. At the same time, however, we do not believe that these relatively subtle changes alone are sufficient to achieve a governance structure that can deliver the best possible value for scheme members over the long-term.

Governance is the foundation on which the success of a pension fund is built – having the right people in the right environment with the right resources and incentives gives schemes the best possible chance of achieving great results, while poor quality governance drastically increases the prospect of failure.

As such, this is a critical topic. For regulators who cannot control external factors such as demographic change or the wider economic context, governance should be the number one priority. Against a backdrop of significant challenges for pension schemes – for example, the significant increase in the number of stakeholders brought into pensions saving through auto-enrolment in the DC space; funding challenges in the case of DB – there is a need for radical measures in terms of the scale, standards and accountability of governance structures.

The Pensions and Lifetime Savings Association has a long track record of research, analysis and training on these issues. For example, our 2005 paper 'Pension Scheme Governance – fit for the 21st Century' outlined the case for a trustees' Governance Code similar to that which has now been introduced for DC trustees in the form of the DC Code. In 2007 we published a review of pension fund trustees' progress against the principles of investment strategy outlined in the Myners Review. In 2009 we established the Pensions Quality Mark recognising well-run occupational pension schemes. We also provide training for trustees on a wide range of areas on an ongoing basis –96% of training participants leaving feedback on sessions rated them as good or excellent.

We will be returning to the theme with our own discussion paper on ideas for bolder governance reforms, to be published shortly, as well as in the reports produced as part of our Defined Benefit Taskforce. In the meantime, our answers to your consultation questions are documented in this paper.

QUESTION 1: THERE ARE CURRENTLY NO BARRIERS TO ENTRY FOR PROFESSIONAL TRUSTEES. SHOULD THERE BE? FOR EXAMPLE, SHOULD ALL PROFESSIONAL TRUSTEES BE REQUIRED TO BE QUALIFIED OR REGISTERED BY A PROFESSIONAL BODY?

Yes – the current situation in which anybody may style themselves as a 'professional trustee' is clearly undesirable. Relevant comparisons with, for example, the legal or accounting professions and the onerous and prominent requirements that are made of them (in terms of professional accreditation; skills and experience; personal probity) are instructive. Pension funds also manage billions of pounds, and thousands of stakeholders are dependent on their success, so appropriate scrutiny of the people paid to take responsibility for their oversight and decision-making is critical

Our research shows that in the past five years alone, the number of schemes using a professional trustee has increased from 44 per cent in 2010 to 58 per cent in 2015. As professional trustees become more commonplace, the importance of safeguards and assurances regarding their quality will also increase.

Demonstrable professional experience as assessed by a professional body could initially accredit professional trustees but eventually a mandatory qualification should be introduced.

We would also expect standards for professional trustees to be set at a higher level than those required of trustees more generally. Achieving the TKU, for example, is a good base but not sufficient for 'professional' status.

QUESTION 2: DO YOU THINK IT IS THE ROLE OF THE CHAIR OF TRUSTEES TO SUPPORT TRUSTEES AND USE THEIR LEADERSHIP SKILLS TO IMPROVE THE LIKELIHOOD OF APPROPRIATE SCHEME PROCESSES BEING PUT IN PLACE? GIVEN THE CRUCIAL ROLE PLAYED BY CHAIRS, DO YOU THINK MORE NEEDS TO BE DONE TO RAISE THE STANDARDS OF TRUSTEE CHAIRMANSHIP? FOR INSTANCE, DO YOU THINK THAT CHAIRS SHOULD BE REQUIRED TO MEET A MINIMUM STANDARD THROUGH HAVING MINIMUM QUALIFICATIONS OR EXPERIENCE OR BELONGING TO A PROFESSIONAL BODY?

We agree that good leadership is critical to a pension fund's ability to achieve the best possible outcome for members and that the role of the Chair is vital to this.

Some of the concerning findings from research into scheme governance relate to aspects of a board's working over which the Chair ought to have some influence. For example:

- The significant number of trustees identified by TPR's research into the 21st century trustee that stated that not all of their board members met the standards set out in the TKU.
- The low number of trustees reporting that they had undertaken any training in the past 12 months (50%) or that their scheme had a training plan (45%).
- The varying time commitment of trustees of different size schemes, with only 25 per cent of small schemes holding quarterly trustee meetings, and trustees of smaller schemes reporting only 9 days per year spent on trustee duties, compared to 16 days for their counterparts from larger schemes.
- The poor record on gender diversity recorded in the 2015 PLSA Annual Survey, suggesting that 83 per cent of pension fund board members are male.

The responsibility for overseeing and contributing to decisions on trustee appointments, succession planning and training and capabilities lies most obviously with scheme Chairs. Similarly, Chairs should be responsible for ensuring that the board collectively and individually dedicates adequate time to their roles.

This suggests there is a case for raising standards for Chairs. As with professional trustees, demonstrable professional experience could initially accredit Chairs but eventually a mandatory qualification should be introduced, and again this should be more demanding than the standards required of ordinary trustees.

It should also be noted that many of the leadership skills required of a Chair – for example, time-planning and prioritisation; communication and people skills; facilitating meetings effectively – are more qualitative and potentially more difficult to assess via a course or exam than the level of understanding of the pensions industry covered by existing codes and guidelines. Any course or qualification for Chairs should reflect this.

QUESTION 3: SHOULD THE REQUIREMENT TO APPOINT A CHAIR AND REPORT ON COMPLIANCE WITH GOVERNANCE STANDARDS BE INTRODUCED FOR DB SCHEMES?

The DC Code, including the requirement to produce a Chair's statement outlining how legislative governance standards have been fulfilled, is widely thought to have been a useful innovation.

A similar document, the Corporate Governance Code, exists in the corporate governance world. The Code is a high profile document, updated periodically, setting out standards for the boards of listed companies, including detailed reporting requirements. While no-one would claim that UK corporate governance is perfect, the

Code does seem to have significantly raised the profile of governance as a critical driver of performance and efficiency and helped to improve standards.

As such, the introduction of a code for occupational DC pension schemes with the same objectives, including the requirement to report on governance standards, is welcome. We agree that it should be extended to other types of scheme.

The one note of caution that we would strike is the extent to which these documents are (understandably) non-critical. It has been suggested to the PLSA that very few DC schemes are likely to produce a report that contains negative messages. As such, it is not sufficient that schemes produce these reports. They should also be subject to appropriate scrutiny.

QUESTION 4: HOW CAN WE HELP TRUSTEES TO BE AWARE OF, UNDERSTAND AND APPLY THE TKU FRAMEWORK?

Targeted communications including conferences/webinars, media articles, online resources (including social media) have all been suggested by PLSA members.

Making the trustee toolkit compulsory would also be an obvious way of raising awareness of the TKU framework and ensuring that it is universally applied.

QUESTION 5: DO YOU HAVE ANY VIEWS AS TO HOW WE CAN HELP NEW TRUSTEES BRING THEIR KNOWLEDGE AND SKILLS UP TO THE REQUIRED STANDARD WITHIN THE STATUTORY PERIOD? FOR INSTANCE, WOULD IT BE USEFUL TO MAKE COMPLETION OF THE TRUSTEE TOOLKIT OR OTHER EQUIVALENT LEARNING TOOL WITHIN SIX MONTHS MANDATORY? OR WOULD THE INTRODUCTION OF A SIX MONTH PROBATIONARY PERIOD FOR NEW TRUSTEES HELP TO MEET STANDARDS OF TKU? WHAT ARE THE DIFFICULTIES ASSOCIATED WITH THESE OPTIONS AND HOW COULD THESE BE SOLVED?

See previous question – we are supportive of compulsory completion of the toolkit within six months, however would caution against anything that gave the impression that this is sufficient to ‘qualify’ as a trustee.

Similarly, a 6 month probation period could be mis-leading – it should be possible to remove under-performing or uncommitted trustees at any time, not just during their first 6 months in post.

Guidance should encourage scheme trustees to continually review and report on their (collective and individual) skills, competences, understanding and learning and development on an ongoing basis.

The PLSA provides extensive training on areas of trustee responsibility - including that go into significantly greater detail than the TKU and enable them to provide more effective governance of their scheme.

QUESTION 6: HOW CAN TRUSTEES DEMONSTRATE THEY HAVE THE MINIMUM LEVEL OF COMPETENCE REQUIRED TO FULFIL THEIR ROLE? FOR INSTANCE, DO YOU THINK HOLDING RELEVANT QUALIFICATIONS IS THE RIGHT WAY TO DEMONSTRATE COMPETENCE? WHAT ARE THE DIFFICULTIES ASSOCIATED WITH THIS OPTION AND HOW COULD THESE BE SOLVED? ARE THERE OTHER OPTIONS?

See response to previous questions – we agree that relevant qualifications and professional experience corroborated by a professional body would help to provide the necessary assurances.

The Corporate Governance Code requires corporate boards to annually evaluate their performance – including their skills, experience, independence, knowledge of their organisation and diversity – and to conduct a review led by an external facilitator every three years. Chair's statements already require trustee Chairs to detail levels of trustee knowledge and understanding – a more explicit commitment to outline learning and development needs (on the same basis as the corporate governance code) would enable better, more transparent communication of the capacity of trustee boards.

Alongside qualifications and accreditation, transparency will be vital to raising standards. It is possible for consumers to find out the performance of many of their key service providers, from their investment manager to their local school. There is no easy and prominent way to do this for pension fund trustees, even though they are no less important. Greater accountability to members would create more pressure on schemes to ensure that their trustees are fully competent and capable.

QUESTION 7: DO YOU HAVE A VIEW AS TO WHETHER A CPD FRAMEWORK WOULD ASSIST TRUSTEES TO MEET THE CHALLENGES OF SCHEME GOVERNANCE? WHAT ARE THE DIFFICULTIES ASSOCIATED WITH THIS OPTION AND HOW COULD THEY BE SOLVED?

We believe that a CPD framework would be useful. As part of the framework, training and development activities should be properly planned and recorded. The issue of finding the time to introduce a framework and maintain a record of related activities is a poor excuse for neglecting such a vital activity.

Employers' willingness to release employees for trustee-related training is a challenge that would need to be addressed.

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

In addition to the TKU (which would presumably act as the basis for the CPD) schemes should also be able to tailor the framework to their individual work programmes.

QUESTION 8: WHAT FURTHER EDUCATION TOOLS AND PRODUCTS WOULD YOU FIND USEFUL TO RECEIVE FROM US?

Ideas of useful resources suggested to the PLSA have included:

- template person specification;
- guides on how to appraise and evaluate skills and competences;
- a CPD framework linked to work of trustees (see previous question) using the toolkit as a foundation but developing this for more advanced learning;
- a network for trustees and chairs, linking new chairs with established ones for first year;
- Links to the work of other organisations working in on trusteeship and governance.

One note of caution however, would be that the feedback we have received on governance advice and guidelines provided by the regulator has been largely positive – it is the lack of awareness of these resources that is the greater problem. Some of our members have suggested that it would be better to enforce existing standards and best practice rather than create further guidance.

The PLSA produces a number of resources for trustees include 'Made Simple Guides' on investment issues; networking events; and training courses developed in partnership with our members drawn from the UK pension fund industry. 96% of training participants leaving feedback on sessions rated them as good or excellent. The most effective trustee training and development should be industry led, ensuring that the relevant courses, resources and materials are based on the needs of those who have first-hand experience of working as or with trustees.

QUESTION 9: WHAT DO YOU THINK IS THE BEST WAY OF MANAGING CONFLICTS OF INTERESTS? HOW COULD THE SYSTEM BE IMPROVED TO REDUCE THE LIKELIHOOD OF CONFLICTS ARISING IN THE FIRST PLACE?

Boards should have a clearly stated conflicts of interest policy that should be explicitly stated during recruitment and appointment processes; at the outset of every meeting; and in annual reports.

The best possible safeguard is a diverse and highly-skilled trustee board, who can identify potential conflicts of interest; understand their responsibilities as a trustee and the separation between their other roles; and have the strength of character to challenge potential conflicts of interest.

Finally, it should be noted that some conflicts of interest will be impossible to eliminate – for example, those who best understand the sponsor's business model are likely to have much to contribute to governance. This creates potential conflicts around responsibilities to members and the sponsoring business – what is important that these unavoidable conflicts are transparent and that there are processes in place to manage them.

QUESTION 10: WHAT DO YOU THINK ARE THE KEY CHALLENGES FACED BY TRUSTEES IN ENGAGING EFFECTIVELY WITH ADMINISTRATION AND INVESTMENT GOVERNANCE AND THIRD PARTY PROVIDERS AND ADVISERS? WHAT COULD WE DO TO HELP THEM IN ADDITION TO WHAT WE OUTLINE ABOVE?

The PLSA annual survey found substantial differences in the costs paid to external advisors, with the cost per member of investment management and custody for DB schemes at the 75^{th} per centile of those surveyed over 70 per cent higher than at the median.

These differences may well result from differing priorities leading to different strategies resulting in, for example, differing investment costs. Equally, there is a strong possibility that they result in part from differing capacities to achieve best value from external advisors.

This would be troubling. If accumulated over the course of an individual's working life, these differences in costs would impact significantly on the total value of the pension fund and the cost to its sponsors and/or the income enjoyed by members in retirement. Therefore, it is vitally important that scheme governance bodies are able to thoroughly assess the need for external advisors in a considered and balanced fashion, and secure the best value deal for their services.

Bespoke training has a role to play in this respect, but well-governed schemes ought to have sufficient expertise to enjoy intellectual parity with consultants, fund managers and other third-party service providers. The level of expertise and experience required is not something that can be developed at short notice.

As such, there is a question of whether or not there should be some level of compulsion in terms of either consolidation (see question 11) or appointment of professional trustees for those schemes found to be unable to achieve value (based on wider benchmarking).

QUESTION 11: WHAT SHOULD BE DONE WITH THOSE SCHEMES THAT ARE UNWILLING OR UNABLE TO DELIVER GOOD GOVERNANCE AND MEMBER OUTCOMES? IN PARTICULAR, SHOULD SMALL SCHEMES

BE ENCOURAGED OR FORCED TO EXIT THE MARKET OR TO CONSOLIDATE INTO LARGER SCALE PROVISION? IS REGULATORY INTERVENTION REQUIRED TO FACILITATE THIS OR CAN IT BE ACHIEVED THROUGH EXISTING MARKET FORCES?

The benefits of scale are well-documented. The UK has almost 6,000 Defined Benefit schemes alone. In the countries with the most highly-regarded pension systems, numbers are much lower, and policymakers have actively concentrated on reducing them.

- In the Netherlands, for example, numbers have fallen from over 800 in 2005 to 365 in 2015.
- In Australia, the number fell from around 5,000 in the 1990s to around 500 by 2009.
- In Denmark, the number of schemes has been reduced to just 25.

Denmark, Australia and the Netherlands are ranked first, second and third respectively in the 2015 Melbourne Mercer Global Pension Index, partly in recognition of the value for money that their large scale pension provision provides.

Having fewer pension schemes reduces the difficulty in finding the necessary number of individuals with the appropriate skills to populate trustee boards. In addition to safeguarding against the dilution of risk governance standards, fewer, larger schemes and a consolidated trustee base would be less complex to regulate.

Research also suggests that larger schemes tend to be better governed, with the ability to achieve better costs from investment managers and attract higher calibre trustees. For example:

- **DNB Working Paper 474, Scale economies in pension funds (2015)**, found that a pension fund that has 10 times more assets under management has on average 7.67 basis points lower annual investment costs. The study attributes this solely to management costs.
- **Do Larger Funds Perform better?, State Street Investment Analytics (2013)** found that the largest local government and corporate pension funds had generally out-performed the market. State Street conclude that while larger funds alone will not achieve better returns, they create the potential to reduce investment management costs; manage investments in-house; and achieve better governance.
- **Keith Ambachtsheer, 'Why we need a pension's revolution' (2007**) identifies scale as critical to achieving lower unit costs.

> Ambachtsheer also argues that greater scale enables pension funds to afford the expertise to run the pension fund according to sound governance principles.

In an ideal world, consolidation would occur through market forces, but progress has been slow in this respect. As such, we believe that an element of compulsion – as has been applied in other markets –would now be appropriate.

QUESTION 12: WOULD YOU FIND IT USEFUL TO SEE OVERARCHING GUIDANCE COVERING ISSUES COMMON TO ALL SCHEMES, WITH MORE SPECIFIC ISSUES BEING COVERED IN TECHNICAL GUIDANCE?

See Question 3 – we believe that an over-arching governance code has benefited boards in the corporate sector and could provide similar clarity for pension funds.

QUESTION 13: DO YOU HAVE ANY OTHER THOUGHTS ON THE ISSUES RAISED IN THIS PAPER OR ON HOW STANDARDS OF TRUSTEESHIP AND QUALITY OF GOVERNANCE?

The PLSA believes that good governance is the foundation from which all else follows for effective pension fund administration. Regulation should concentrate on ensuring that the right people are in place to oversee pension funds and that they operate within the right structures with the right incentives. If this is achieved, then the right decisions should follow, leading to the best possible outcomes for member and reducing the need for costly and sometimes burdensome regulation.

Governance will be a feature of our policy work over the coming months. We will shortly publish a paper outlining the case for and characteristics of good governance, and look forward to working with TPR on an ongoing basis on this important agenda.

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