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Future of Trusteeship and Governance

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The Pensions Regulator has published an industry consultation on the future of trusteeship and governance.

It is concerned with the levels of poor governance it has uncovered and has announced that badly run schemes need to improve or consolidate.

The consultation poses questions to the pensions industry, across a number of areas, including how to improve and evidence trustees' knowledge and understanding, how to improve diversity of trustee boards, whether to mandate for a professional trustee on every board, its concerns over sole trustees, and whether barriers to defined contribution (DC) scheme consolidation can be removed.

The consultation runs until 24 September 2019.

Background

During its 21st century trusteeship campaign the Pensions Regulator has obtained further evidence (e.g. through annual scheme surveys) that there remains a subset of disengaged trustees that are unable or unwilling to take action to improve scheme governance, particularly in relation to small (12-99 members) and micro schemes (less than 12 members).

The Regulator, over the years, has consistently suggested smaller schemes are more likely to be badly run than larger ones. David Fairs, Executive Director of Regulatory Policy, accuses trustees of many smaller schemes of being "either asleep at the wheel or not taking their responsibilities seriously and as a result the governance of some schemes is, frankly, breaching the law".

He says "too many trustees of small schemes aren't doing a good enough job" and that the evidence the current system does not work for all is stark. While the trustee model is not broken it needs to be greatly improved.

Trustee Knowledge and Understanding

The Pensions Act 2004 introduced a statutory requirement to ensure that trustees had sufficient knowledge and understanding (TKU) of the law relating to pensions and trusts, as well as the principles relating to the funding of pension schemes and the investment of scheme assets. Trustees are also required to be familiar with certain scheme documents including the trust deed and rules, the statement of investment principles and statement of funding principles. New trustees are generally given six months from their appointment to get up to speed.

The Regulator points out that attaining an appropriate level of knowledge and skills is not a onetime event, and trustees should be able to demonstrate a minimum level of annual ongoing learning through formal Continuing Professional Development (CPD)-type training, for example, board training days to learn about new developments, or attending courses, lectures and conferences.

The Regulator will be revisiting its TKU code and revising it in the light of changes since its last review in 2009 and is considering whether legislative changes are required for demonstrating a minimum level of TKU and a minimum level of CPD-type training.

Improving diversity of trustee boards

The consultation acknowledges that a lack of diversity on some pension scheme boards has been recognised for a number of years. It references evidence that diverse groups are more effective at making decisions and that diversity on trustee boards is seen as a key benefit of the trustee model (with diversity improving understanding of the challenges the members of the pension scheme face).

The Regulator is quick to point out that it does not support some form of quota on pension board make-up and that it does not want to force the removal of good trustees with valuable skills in the pursuit of quotas. It does, however, comment on the predominance of male trustees on trustee boards and highlights the number of boards of trustees where the chair is over age 60.

The Regulator asks whether schemes should report on what actions they are taking to ensure diversity on their boards and talks about exploring ways in which the industry can encourage a greater diversity of strong applicants for trustee roles. It points out that employers could benefit from the newly developed skills that trustee employees will bring to the workplace (such as communication, decision-making and influencing).

Mandating for professional trustees

There is a higher expectation placed on professional trustees and higher penalties will be imposed on them when they get things wrong. The Regulator welcomes the voluntary accreditation framework for professional trustees, being put together by the Pensions Management Institute and the Professional Trustee Standards Working Group (PTSWG), which is also currently the subject of a consultation. Whilst this will be voluntary, the Regulator hopes that in time the accreditation route for professional trustees will become the norm across the industry.

The Regulator suggests the vast majority of trustee boards would benefit from having an accredited professional trustee on their board. Whilst recognising there are currently not enough professional trustees for every scheme to have one on its board, it is clearly minded to move in the direction of at least suggesting that in five years' time it would expect to see the number of professional trustees to rise. It is also asking the question as to whether it should seek legislative change to mandate the appointment of a professional trustee onto each pension scheme board from a date in the future or why this would be undesirable.

Concerns about sole trustees

The Regulator is aware that some employers with defined benefit (DB) pension schemes are moving to sole trustee run pension schemes and questions whether sole trustees can run pension schemes appropriately even where, for example, that sole trustee acts on behalf of a corporate professional trustee firm.

The Regulator believes that a sole trustee would struggle to replicate the advantages (that it has already highlighted) of robust decision-making based on a diversity of views. It goes on to express concern about the loss of saver representation, the risk of potential conflicts of interest and difficulties of maintaining good levels of governance (e.g. where discussions could be misinterpreted or misrepresented where only one trustee attends a relevant meeting). The Regulator is asking questions to increase its understanding of how this (and other corporate trustee models) operates.

Barriers to consolidation of DC schemes

The Regulator will be seeking to facilitate and encourage scheme consolidation for schemes which are not meeting the required governance standards. It suggests authorised master trusts should be the route for consolidating DC schemes, with Group Personal Pensions (GPPs) as an alternative.

The Regulator is working with the DWP to find a solution to support DB consolidation. They are currently in discussion over the shape of an authorisation and supervision regime for DB superfunds.

This consultation is, therefore, focussed on removing the barriers to winding up for DC schemes with guarantees (such as guaranteed sum assureds, guaranteed annuity and/or growth rates). The Regulator asks questions about possible solutions that provide some protection for members who have guarantees.

Comment

The consultation says things need to change. The Regulator is evolving into a more visible and proactive regulator and is working in a clearer, quicker and tougher way. Inevitably this is going to impact on the future of trusteeship and governance.

David Fairs says that the Regulator will “have to make life more uncomfortable for the people who sit there in blissful ignorance, not doing the right things”. He says “that may for the first time be a little bit painful for those trustees where they start to get fined for breaches of regulation”. A promise is made that schemes can expect a higher level of regulated activity going forward as over the next two years the Regulator will proactively drive up a range of specific governance and administration standards through a number of regulatory initiatives. To this end it singles out for particular attention, investment governance, record-keeping, prompt and accurate financial transactions, costs and charges, and trustee knowledge and understanding.

It’s clear that this activity is not limited to just small and micro schemes. Medium schemes (100-999 members) and the biggest schemes (25 of which have already received one-to-one supervision) are also mentioned in the consultation. The number of schemes that will be subject to this regular and ongoing contact will grow in the next year or so as part of its new regulatory approach.

Now that trustees have been put on notice of this change of approach by the Regulator, ahead of the coming storm, it would be wise for trustees of schemes of all sizes to carry out a governance audit and ensure that they are not only acting correctly, but the proper paperwork is in place to prove it.

Trustees have already been asked to consider their governance structure as part of the 21st century trusteeship initiative, with tools available for looking at diversity on the trustee board, the skills and experience of trustees, and consideration of professional trustees.

Consolidation of DC schemes has already begun, but there are some helpful solutions being considered for those that cannot do so. Consolidation of DB schemes is being considered separately and we await more information on this.

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