Muse Advisory response to TPR's 21st Century Trusteeship and Governance Discussion Paper

September 2016

We welcome the Pension Regulator's initiative on 21st Century Trusteeship and Governance. This document forms Muse Advisory's response to the questions set out in Annex A to TPR's discussion paper.

Summary

We are pensions governance specialists working with a large number of pension trustee boards on their governance and effectiveness. We work with many trustees and boards that exhibit all the required attributes to fulfil the role effectively, and some that, for different reasons, do not.

We have provided our thoughts on this discussion paper in this document and have summarised our key thoughts here:

- It is important to be clear about how the different trustee roles are defined, distinguishing between professional, independent and lay trustees.
- The role of the trustee is widely discussed, but often the focus is largely on technical knowledge. In our experience, some of the best trustees are not from a pensions background, and do not have a detailed technical knowledge. However, what they do have is the right skillset and the intellectual capability to grasp complex ideas, challenge advisers appropriately, identify/ manage/ prioritise risks and participate actively in decision making. Both technical and softer skills are important and should be considered during the trustee appointment process.
- The role of the chair requires chairmanship, leadership, negotiation, listening, facilitation and other softer skills which are equally, if not more, important than technical skills but are sometimes overlooked.
- There should be a requirement for a base level of technical knowledge that is refreshed regularly, perhaps built around the trustee toolkit. More importantly, there needs to be greater access to coaching and training sessions, seminars and other forums that address the skillset required of being a trustee, and not just the latest changes in pensions legislation.
- Pensions is the only significant industry in the UK that does not currently have some form of mandatory board effectiveness assessment. There is a lot to learn from the corporate sphere. As a minimum, trustee boards should be required to annually self-assess and comment on key outcomes in an annual statement. There should be triennial external assessments to challenge the self-assessment and provide an independent perspective.
- We would welcome the introduction of the reporting requirements of DC schemes into the DB arena. We think this will challenge many trustee boards to think objectively about how they operate.

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Response

Before we address the questions raised in the discussion paper, we think it is important to be clear about what we mean when we talk about a) professional b) lay trustees and c) independent trustees. In our view there is a distinction to be drawn between these three.

a. As you identify in the discussion paper, professional trustees are those that hold themselves out to be an expert in pensions, or specific aspect of pensions, and can therefore be expected to deliver to higher standards than that of non-professional trustees. They are likely to be remunerated for their role. They may have related professional qualifications and direct industry experience, but also may not have.
b. Independent trustees will include a large group of people who are not pension experts but have been or are executives or non-executives on other company/ pension/ trust boards and bring their experience to the fore. A number of excellent trustees come from this category.
c. Company and member-nominated trustees tend to be lay trustees but some of them can be quite experienced having served for a number of years and built up a level of knowledge. They are unlikely to have any qualification in pensions or a background in this industry.

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?

We believe that it would be good if professional trustees (those that hold themselves to be experts in pensions) had a relevant qualification; indeed, we think many independent trustee companies would put their staff through such a qualification and this is to be welcomed.

However, there is an impact on independent trustees as we define them above. Requiring this group to have a relevant qualification risks making them too expensive to be appointed as trustees in the small pension market and may discourage them altogether from being a trustee in larger schemes. This would be to the detriment of those who are excellent trustees and exhibit the required soft skills for the role such as managing conflicts, chairing a board, facilitating debate and challenging advice, but do not have the detailed knowledge of pensions that such a qualification might test.

To bring some clarity, we believe that it is more important that trustees should become more accountable for their training, their continuing 'professional' development and for their decisions. So, rather than a qualification, setting out trustee expectations, key role descriptions, required skills and some level of assessment cognisant of the category of trustee they fall into would be a pre-requisite. This should include the completion of the trustee toolkit at least every two years and attending pensions industry training and networking events that are relevant to their role (the latter particularly for professional and independent trustees as we define them above). Membership of an appropriate professional body could well facilitate this and should perhaps be a prerequisite for a professional trustee and offer encouragement for all other trustees to join.

It is also important to state that any qualification in no way should be a substitute for appointing the right advisers. Trustees should focus their attention on challenging their advisers appropriately rather than second-guessing or testing the advisers. With the increased complexity and materiality of pensions, staying clear about trustee role expectations versus adviser roles is ever more important.

In conclusion, whilst a qualification may be a useful marker of the required knowledge, it is not as important as some of the softer skills required of good trustees, something which a professional body could promote. Technical knowledge could then more usefully be monitored and evidenced by a CPD framework, which includes relevant requirements that address softer skills such as facilitation, performance management, encouraging participation etc.

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?

Yes. It is absolutely the role of the chair of trustees to support trustees and improve the likelihood of good scheme processes being in place. It is an important role. The chair requires additional skills, as you have noted in the discussion paper, and this comes with extra responsibility. The role description of a trustee chair is poorly understood in the market.

The role of the chair is clearer in DC schemes, although this is a relatively recent improvement. The same needs to happen in the DB market. The expectations of the chair need to be made clearer, as it has been in most other sectors outside pensions in recent years.

As mentioned above, the softer skills are key and this has been an area that has been typically weak in the pensions industry. In the corporate sphere there is access to a number of courses and seminars for chairs, directors, non-executive directors and other chairing roles that focus less on technical knowledge and compliance and more on the skills required to successfully fulfil the role. This is something that could usefully be brought to the pensions industry through encouraging chairs to complete a CPD framework that is built of an appropriate balance between technical and softer skills.

We strongly believe that governance is a fuller remit than is currently understood. We are not aware of a body that currently provides the right type of training for pension trustee board chairs that goes beyond technical and compliance. This is a void that TPR could use its influence to address.

Such training would also be excellent for aspiring chairs, which we have seen used to good effect in other sectors. Again, membership of a recognised professional body could promote and encourage this and we agree should be a minimum requirement for an active chair.

Question 3

Should the requirement to appoint a chair and report on compliance with governance standards be introduced for DB schemes?

Yes. We would strongly support this and believe it would help to address issues in the smaller scheme market. It is staggering that there are some schemes without a chair (if they are not sole trusteeship arrangements) and surely this cannot be delivering good outcomes.

We have expanded on our thinking around the proposed statement in response to other questions.

Question 4

How can we help trustees to be aware of, understand and apply the TKU framework?

The statement proposed by question 3 would be the best place for this. In our view, this ought to be a Chair's statement that includes an annual self-assessment of TKU, and confirms compliance with a new mandatory requirement to refresh the trustee toolkit every two years. As refreshing the toolkit for some would be too basic, the availability of a more advanced version would be welcome and should be a requirement for a chair.

To enforce more rigorous standards for trustees, an appropriate level needs to be set. Trustees do not require encyclopaedic knowledge of technical pensions issues, but they do need to be able to challenge and understand their advisers who were appointed to provide this depth of knowledge in simple and clear terms. The TKU framework is too burdensome and granular to be mandatory, and we would suggest that the trustee toolkit would provide a suitable solution.

The toolkit would be the foundation knowledge expected of trustees with the self-assessment of TKU more generally providing an extra level of comfort that, across the Trustee Board, there is adequate expertise and knowledge.

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?

As we have suggested in our response to question four, we believe the toolkit should be mandatory every two years with a more advanced version being available for those that want it and for chairs. At the outset, however, there is a need for expectations to be made clearer.

New trustees are already required to complete TKU requirements within six months and this can be tested in some cases using the trustee toolkit. The danger of broadening this requirement to cover more general TKU is the potential to create difficulties filling vacancies. The TKU framework is large, and daunting to a new trustee. Fuller induction for lay trustees in particular takes time, building TKU through trustee work for the particular scheme in most cases.

A six-month probation would not serve a useful purpose. In any event, trustees are accountable and responsible for the board's decisions from the day of appointment and they need to be able and capable to play a part in those decisions. Our suggestion would be to focus on appointment procedures more closely and, in this particular matter, make better use of induction and pre-appointment processes. For example, a six-month window pre-appointment would allow for the completion of the toolkit, meeting observation and a full induction into the scheme from advisers and existing trustees. This would result in trustees being much better prepared to take responsibility and play an active part in the running of the scheme from day one.

We would strongly advocate more robust appointment processes and selection criteria to avoid appointing individuals unfit to be trustees or who are unprepared for the commitment and training required of the role.

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 question 5.

To reiterate, our belief is that the toolkit would serve as an adequate indicator of a minimum level of technical knowledge and intellectual capability. Softer skills can then be assessed through a performance management framework falling under the remit of the chair.

In our response to question 5, we briefly mention selection criteria. To expand on our thinking, we believe that appointment processes should be looking for transferrable skills and similar role experience (corporate, school governor, charity etc.). This has been an issue since the introduction of trustee elections which weren't properly framed by a mandatory or suggested role profile or selection criteria, which has meant that trustees can be elected that do not have the ability or experience to adequately fulfil their role and duties. Similarly, trustees are being nominated by sponsoring employers or other nominating bodies who again do not have the ability or genuine desire and commitment for the role. This can hold back a board's overall effectiveness and unfortunately adversely impact on outcomes.

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?

As mentioned earlier, we would be a strong supporter of an appropriate CPD framework. However, as we have stated, this needs to be about the trustee role, not technical pensions knowledge.

The difficulties with this being that many trustees, particularly those still active employees of a sponsor, can be time-poor and will need employer support in meeting the requirements.

Question 8

What further education tools and products would you find useful to receive from us?

We would suggest:

- Online case studies and practical examples from your experience
- Webinars featuring practitioners addressing practical issues and challenges
- Signposting where good quality training and trustee learning can be undertaken
- Clear guidance on the qualifications and membership bodies that TPR supports
- Availability of a more advanced version of the trustee toolkit.

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?

Key contributors to effective management of conflicts, in our view, are:

- Transparency and training on conflicts of interest and how to recognise a 'conflict' versus an 'interest'
- Use of professional and genuinely independent trustees on trustee boards

- Inclusion of more robust conflict assessment in appointment processes, such as consideration of the practical impact of "what if" scenarios and how these would be managed
- Regular refresher training for the trustees

Conflicts are something that could also be covered in a chair's statement. For example, this could be confirmation that a policy and suitable processes are in place to manage conflicts.

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?

Some key challenges are:

- Time
- Pace and level of work
- Understanding
- Intellectual capability to grasp complex issues
- Poor advice including jargon, lack of accompanying training
- Poor trustee understanding of assurance processes and/or of how to hold administrators and advisers to account
- Inability to challenge or too much reliance on those trustees perceived to have greater knowledge or experience (apprehensive to ask questions or clarify issues)
- Group think encouraged by dominance of one or more trustees (or others e.g. advisers, pensions manager)
- Trustees acting as if they are advisers, which is a particular issue with some professional trustees that have either been on a board for a long time with less experienced trustees or who were advisers in a previous career.

There is also a limited understanding, in our experience, of the risks associated with administration. There is a general inability to look beyond the performance and service level indicators to see, for example, data issues, poor processes and quality controls.

Administration, and more generally adviser, reporting is an area where TPR could usefully provide some guidelines and practical guidance for trustees.

In addition, TPR could encourage formal feedback and review mechanisms for advisers. Advisers can provide useful feedback to trustees on how well they are doing.

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?

TPR needs to intervene earlier and more frequently to prevent issues arising. There may not be a need to enforce exit or consolidation if TPR creates the conditions that make consolidation a favourable option. Not that consolidation in the form of, for example, mastertrusts is a panacea (many mastertrusts in the DC environment are not viable longer term); professional sole trusteeship should also be considered. Increasing the oversight and monitoring of smaller schemes and applying more robust guidelines on smaller schemes will help to achieve this.

We acknowledge that smaller schemes and the large schemes are very different, and have very different governance challenges. Too often we believe that this difference is used as a means not to apply strict guidance to smaller schemes, but this is a challenge that the corporate sphere has easily overcome.

For example, corporate board assessments carry different requirements for the largest of companies and SMEs. We see no reason that the pensions regulation cannot differentiate between large and small schemes in the requirements that apply and the scrutiny they receive.

The pensions sector is the only major one in the UK that does not now carry a board assessment requirement, yet the downside risks to the UK economy and to millions of individuals' long term financial wellbeing that are carried in the sector and overseen by trustee boards are some of the most significant we face.

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?

Yes, although we believe that guidance and governance requirements can, and should be, applied differently to different sized schemes.

This could be supported by case studies and webinars. There needs to be a balance. The amount of guidance can quickly become burdensome both in terms of compliance for trustee boards and monitoring for TPR.

Pensions is the only industry that does not currently have some form of mandatory self-assessment. There is a lot to learn from the corporate sphere in this, and other areas. Trustee boards (including committees and individual trustees) should be required to annually self-assess and report results in a statement. There should be triennial external assessments to challenge the self-assessment and provide an independent perspective.

This could be backed up with some form of accreditation or recognisable benefit to a well governed scheme, such as discounted insurance or PPF levy deductions.

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 can be improved?

We think it is worth briefly covering the professionalisation of trusteeship and the potential impact of this on smaller schemes. The potential level of qualification (being considered by the PMI), coupled with your 21st Century Trustee campaign suggest this is the route the industry is taking. This may be welcome by the independent trustee companies, but may well be to the detriment of long-serving, experienced, and competent trustees, or, for that matter, anyone looking to become a trustee in the future.

Your research suggests that many trustee boards find it easy to find trustees. This has not been our experience with clients, and often those most suited or qualified for the role do not have the time to commit to it. We don't see this improving for DB schemes at least, as longer term they are dying institutions often with problems/ issues that may be seen as insurmountable. As a result, more disengaged and reluctant people can have their arms twisted and end up as trustees. This could exacerbate the issues that are concerning TPR.

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