

August 2016

The Pensions Regulator  
Napier House  
Trafalgar Place  
Brighton  
BN1 4DW

Dear Sir/Madam

**RE: 21<sup>st</sup> Century Trusteeship and Governance**

This letter represents the response from HR Trustees Ltd to your Discussion Paper with the above title from July 2016.

At the outset, we would like to make clear our support for this focus on ensuring that the industry is served by trustees that best represent the interests of members. The environment for schemes is becoming increasingly complex and funding levels and sponsor finances mean that there are often no easy answers to the questions facing trustees today.

We append responses to the 13 questions posed below. We suggest that a distinction is created between underperforming schemes who have the resources to improve governance, processes and investment strategies and those who lack quality in these areas due to severe sponsor wherewithal shortfalls. In the former case, we broadly agree with TPR's approach to create additional structure but not additional regulatory burdens upon them. In the latter case, it must be worth exploring mechanisms such as consolidation or routes to ease the paths to compromises that relieve the pressures on both sponsors and member outcomes.

Yours sincerely,

HR Trustees

**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?**

There are currently barriers to entry for professional trustees in most cases driven by the requirement for a tender process by most schemes often led by the legal advisor or consultant. A list of potential qualified providers is drawn up and both written proposal and verbal presentations to representatives from the trustee board and sponsor are made. These address both the technical capability to meet the specific needs of the scheme and the likely personality fit of the individual. There are also instances where a trustee is well known to an adviser or even a scheme member where a good fit is already recognised.

Providing guidance for trustee chairs and sponsors as to what skills they should look for in a trustee could be useful particularly to guard against instances where these “professionals” are appointed for reasons other than an independent evaluation of their fitness to serve in this role. The performance of professional trustees should be evaluated regularly (perhaps as often as annually) by fellow trustees against these criteria and clear procedures should be in place for removing trustees who do not meet requirements. In this way good standards should be better maintained.

Included in this guidance should be an acknowledgement of the professional qualifications the candidate may possess ranging from the basic (Trustee toolkit completion) through actuarial, legal, investment and, perhaps, the proposed PMI diploma in Trusteeship. Technical qualifications should not be made mandatory but may increasingly become a filter for those not obviously qualified in other ways. For example there are many highly experienced and respected professional trustees for whom the time and expense of gaining additional technical qualifications will not make them better trustees. For others entering the field, these qualifications may prove valuable to their candidature.

All professional trustees should be registered by a professional body whether they be individuals or professional trustee companies. Without a registration process, it is not realistic to assume that this increasingly important role is capable of being monitored and controlled by the regulator as may prove necessary in the future. The registration process should be oriented around providing information about the individual or company that is offering services. It should remain separate from registers to which trustees and trustee companies are selected on merit.

**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?**

Similarly, to the answer to first question, it will not be qualifications that will give rise to good Chair skills. Guidance is appropriate as to the types of skills that would be required but too much technical expertise can be a barrier to performing in a well balanced fashion as Chair. As mentioned, the Chair should demonstrate leadership in ensuring the efficient running of the scheme and supporting fellow trustees to perform at their best. A Chair should be conversant in the language of pensions and of industry practice more broadly in order to be efficient and effective which is why some are appointed only after spending time as a trustee of the scheme first. Too much proscription will likely be counterproductive, however.

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

Whilst we do not support additional regulatory burdens on trustees, it is easy to see that a scheme with several trustees but no trustee chair will find it more difficult to perform through their duties efficiently. Clearly, schemes with sole trustees would not be required to appoint a chair. Requiring a report on governance standards would be very expensive to implement across the industry when, if advisers are performing their role effectively, compliance with effective governance will be measured regularly as part of meeting agendas.

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

The simplest method would be a statement by the Chair with respect to compliance with this requirement in the report and accounts. The requirement to do this will feed through to more active management of this during the year.

**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 DB schemes continue to close to new accrual, notwithstanding TPR's recent research, it will become increasingly difficult to recruit engaged and competent trustees since these schemes are no longer related to their ongoing benefit package and an increasing proportion of members will be deferred or retired. This doesn't mean that trustee standards can be allowed to drop; in fact the demands of lower funding levels, more challenging market conditions and higher incidences of weak covenants makes the

case for even higher standards. Both requirements suggested here make sense in this context. There can be no excuse for a trustee committed to the role not to have completed the toolkit within six months of joining the board. With respect to the probationary period, this seems a good way to force an evaluation of the new trustee and a discussion around it. One would hope that in most cases this would be a formality but, when there are issues, it can be very helpful to have an established process in place to make a change.

**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?**

All new trustees should have completed the Toolkit promptly upon joining and have passed a probationary process (see answer to 5. above). All ongoing trustees should be current on the toolkit as a minimum (including the proposed refresher modules). It seems sensible for there to be a rolling review process of each trustee (including the Chair) by fellow trustees at least every 3 years. Good trustees have a range of personal skills that allow a balanced board to operate effectively with strong governance credentials. Qualifications have their place but don't directly correlate with competent trusteeship so they may, perversely, allow incompetent trustees to continue in place just because they have improved their technical knowledge but continue to lack the required personal qualities.

**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?**

Every scheme is different and, noted in TPR research, many trustees will find specific CPD requirements difficult to manage due to conflicting demands on their time. A good way to address this is to recommend this as a standing item on the trustee meeting agenda and a discussion can be had about finding the best way to ensure that trustees remain current with industry topics and to bring focus to any shortfalls in this respect.

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

None - although continued refinement of the toolkit could be useful perhaps incorporating basic and advanced levels to reinforce solid baseline knowledge.

**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?**

Conflict management should be a standing item on the meeting agendas already. If the conflict in question relates to the way a professional trustee is behaving and raises concerns that he/she may be

influenced by the fact that the sponsor hired them and pays them, this should be discussed openly as part of this item and addressed. If it can't be resolved, it may be time to change that trustee since every trustee should know that their primary responsibility lies with the interests of the members. If the conflict relates to a third party provider of services to the scheme, this should be tabled in the same way and action must be taken to manage this conflict.

**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?**

With respect to administration whether it be DB or DC, if trustees were all aware of the importance of good administration to the effective management of any scheme, it would improve engagement and relationships with providers of this service. The same could be said about governance. If the regulator were to publish examples of failures in both instances, this would provide further focus on this. Challenges with respect to investment advisory are dominated by the conflicts faced by advisors who are also providers of the services (e.g. asset management or fiduciary management) upon which they advise. We would recommend that the regulator research this issue further and be rigorous in ensuring that "independent" advice is indeed that. Discipline around conflicts in the advisor arena falls well short of that demanded from banks and other financial institutions and many schemes which rely excessively on advisors (as highlighted in your research) are particularly vulnerable in this respect.

**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 distinction between unwilling and unable is important and may need different handling; however, in either case, moving to a different management model may make sense. The Pensions Trust already provides a DB Master Trust style service which claims significant cost savings under a common governance structure. Care needs to be taken with respect to any "last man standing" multi employer structure as this would not be an attractive option for most commercial enterprise employers. The Dutch regulator has recently established an APF structure there to drive consolidation although many ongoing schemes will convert to collective DC arrangements (perhaps an option for UK schemes under this structure if legislation were finally passed to allow this). Clearly, there will be issues faced by small underfunded schemes with weak sponsors that won't be solved by reducing operating costs but the cost structures around supporting 6000 DB schemes are a drag on the economy so creating scale efficiencies must be desirable and achievable notwithstanding different scheme structures and sponsors.

**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 this seems a sensible approach.

**13. Do you have any other thoughts on the issues raised in this paper or on how standards of trusteeship and quality of governance?**

Recognising the potential conflict of interest posed by response to this question by HR Trustees Ltd, it must be the case that increasing the use of professional trustees in schemes where existing trustees find it challenging to shoulder the increasing burden being placed upon them, will raise standards. Many schemes will be very well managed without need for professional trustees but this industry is unusual in assuming it is appropriate for CNTs and MNTs (both pension amateurs in many cases) to be running multi million pound asset pools with complex administrative and liability structures. This is because the industry evolved via successive legislative action from a best efforts arrangement to a complex senior debt obligation from the sponsor over which it has limited direct control without significant change to the trustee make-up.