SQUIRE PATTON BOGGS

#PensionsTensions: New Dimensions

Part Four: Governance and Trusteeship

Introduction

Welcome to the latest phase of our #PensionsTensions campaign, exploring the current challenges faced by trustees and sponsoring employers of occupational pension schemes. Effective risk management is undoubtedly the key to running a pension scheme well and is the dominant theme in The Pensions Regulator's (TPR's) draft single code of practice. Each factsheet in this series sets out our top "red risks", as well as some mitigation tips and a #PressureMeasure that shows whether we think the pressure on trustees and sponsoring employers is increasing or decreasing. Each factsheet assumes that there is an established risk management system on which additional measures can be built. Do not forget to check our timesaving tip!

In this factsheet, we examine the risks associated with trusteeship and the increasing regulatory expectations regarding governance.

Comment

Running a pension scheme has never been more demanding! All schemes are expected to have first-rate governance systems, no matter how small they are. This has contributed towards the tandem trends of consolidation and professionalisation of trusteeship.

Governance

TPR is consulting on its proposal to replace its existing codes of practice with a new single code. At present, the draft code condenses 10 of the current 15 codes of practice into one. However, this is not just a consolidation. Many policies and procedures will need to be formulated, documented and regularly reviewed for the first time.

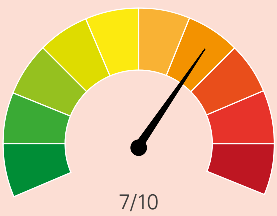
The new code will incorporate the requirements of the Occupational Pension Schemes (Governance) (Amendment) Regulations 2018, including that pension schemes have an effective system of governance. This is an evolution of the existing internal controls framework but contains lots of new requirements. These include a requirement for trustees to prepare remuneration policies covering those who effectively run the pension scheme or carry out key functions. Other new areas relate to climate change, investment stewardship, IT and cybersecurity.

Trustees will need to demonstrate that they have processes in place to review the management of risks and must provide a record of their risk assessment to TPR on request. The final code is expected to come into force towards the end of 2021 and trustees will need to formulate a "reasonable and proportionate approach to ensuring compliance". We anticipate trustees leaning on their lawyers in relation to this judgement call.

The additional compliance burden created by the new code will make scheme governance for small schemes even less sustainable. It seems that TPR has little sympathy for small schemes and points to pension consolidators as the answer to the small scheme problem.

As the risk of making governance errors increases, we anticipate trustee indemnity insurance will become increasingly popular, but the terms of coverage should be carefully scrutinised.

#PressureMeasure: Governance and Trusteeship



7/10

If implemented as drafted, the new single Code of Practice will dramatically increase the governance burden on pension trustees.

Trusteeship

All of the above add to the challenges faced by pension trustees and may impact on recruitment and retention of lay trustees. Whilst many trustee boards have long-standing trustees, who have built up great knowledge of their scheme and become comfortable with risks that are part and parcel of the role, when they eventually stand down, it seems to be increasingly difficult to replace them. This may be because less of the current workforce have benefits in the scheme, or because the responsibility and risk of the role is now considered to be too great.

Into this trustee vacuum has stepped a growing population of professional trustees. In 2021, the introduction of an accreditation system should mean that the quality of professional trustee is more consistent and reliable. There does now seem to be the capacity in the market for most schemes to be able to find a professional trustee, which was a concern until relatively recently.

Once professional trustees have established themselves on trustee boards, and gained the trust of all stakeholders, consideration is increasingly being given to moving to a sole trustee model, with the professional trustee organisation assuming all trustee responsibility. Some scheme sponsors are attracted by the efficiency this can bring. Others are concerned that this will create an unhelpful disconnect between the trustee and the sponsor company.

Where there remain multiple trustees, we are seeing very few continuing to operate as individual trustees. The main attraction of incorporation is the limited liability status of the corporate vehicle, meaning that the trustee directors have an extra layer of protection. Corporate status has also been helpful during the pandemic, as it has meant that only one or two trustee director signatures are required on formal documents, instead of all trustees having to grapple with the challenges of electronic execution.

Diversity on trustee boards is coming under more and more scrutiny. There is still a long way to go in reaching a point where protected characteristics are properly represented around the trustee table. Cognitive diversity is also now coming under the spotlight, the thinking being that the best decisions are made by groups containing individuals with varied views, perspectives and experiences.

Whilst the draft new code says that trustee chairs should have the "ability to gather and understand diverse views", there is no apparent requirement to ensure that your trustee board is made up of individuals with diversity of background or views. We anticipate that TPR will come under pressure to fill this notable gap in the regulatory requirements.

Red Risk Flags

- Are any of the trustees' policies and procedures gathering dust having not been reviewed for a long time?
- Can trustees point to an insurance policy that will help protect them if there are ever any proceedings or claims against them?
- Are there vacancies on the trustee board?
- Is the makeup of the trustee board inconsistent with the diversity amongst the scheme's membership?

Mitigation Tips

- Start by refreshing and updating current policies, as this will minimise the work needed to comply with the new code.
- Take a high-level look at the new policies and procedures that will be needed and assess how they can be incorporated into any current activity.
- Consider having trustee "reserves" who can step in as and when a vacancy arises.
- Look at how the sponsoring employer is promoting diversity and inclusion, and consider whether the same strategies can be applied to the trustee board.

What the Regulator Says

"Under new regulations, trustees must have an effective system of governance proportionate to the size, nature, scale and complexity of their scheme. Private sector schemes with 100 or more members will now need to carry out an own risk assessment. TPR expects governing bodies to use this to assess how well their policies and procedures address various risks, financial and operational, that their scheme faces." Link here.

Time-saving Tip

Checking indemnity insurance coverage carefully now can save time and money in the long run, because there may be coverage for the costs of dealing with member complaints and investigations by TPR.

Key Contacts

Matthew Giles
Partner, Birmingham
T +44 121 222 3296
M +44 7974 836515
E matthew.giles@squirepb.com

Peter Stanley
Associate, Birmingham
T +44 121 222 3522
E peter.stanley@squirepb.com

41477/06/21