SQUIRE PATTON BOGGS

Protect Against Unmitigated Liabilities #meetPAUL #How2DoPensions

Campaign Overview

Earlier this year, we conducted a survey to assess how confident trustees and corporate sponsors felt about 10 fundamental areas of pensions risk. We focussed on areas not directly covered by the Integrated Risk Management Framework, and asked respondents to rank the risks in order of their "stay awake" factor. We have now produced a series of 10 factsheets, each one commenting on one of the survey risks. Our red risk flags highlight some key warning signs, and our mitigation tips are designed to supplement existing areas of risk mitigation. Each factsheet assumes there is an established risk management system on which additional measures can be built.

Risk 10: Weakness in Investment Governance and Documentation

Survey Result

This was the lowest-ranked risk in our survey overall, but was of greater concern to our trustee respondents than our corporate respondents. It is not included on 44% of our respondents' risk registers.

Comment

We would have expected this risk to rank much higher. Even if the likelihood of the risk occurring appears small, the effect on a pension scheme could be material if it crystallised.

Investment is a highly technical and evolving subject. It is vital for trustees to devote enough time to setting an investment strategy appropriate for the scheme (including environmental, social and governance factors). Investment decision-making should be approached in a structured way. Trustees should be equipped with the knowledge and skills to critically evaluate investment advice and appoint investment advisers who can give explanations at a level appropriate for the group's understanding. Trustees should also allow sufficient time for legal advisers to assess contractual risks and negotiate appropriate protection against those risks.

Trustees also need to keep abreast of recent and emerging legislative requirements, including setting strategic objectives for their investment consultants by 10 December 2019; arranging competitive tenders (where fiduciary managers have been appointed); and ensuring that the scheme complies with a variety of new requirements affecting the statement of investment principles and investment disclosures in general.

Red Risk Flags

- Trustees do not have the knowledge and skills to critically evaluate investment advice.
- Not all trustees participate fully in investment decision-making or performance reviews.
- Investment strategy is not aligned to scheme objectives.
- Trustees do not seek or do not allow sufficient time for legal review of investment contracts before making a new investment.
- Trustees are not aware of risks associated with costs, liability or liquidity in the scheme's investment arrangements.

Mitigation Tips

- Evaluate the need for training before investment decisions are taken.
- Review the scheme's investment decision-making process and ensure that sufficient time is allowed for all key steps.
- The trustee chair should ensure that investment advisers communicate at the right level for the trustee group.
- A general "stock-take" of strategic, contractual and legal requirements affecting the scheme's investments could be scheduled.

A Word from The Pensions Regulator

"We consider it good practice for trustees to review the managers' fund documentation, obtain appropriate legal and investment advice, and explore negotiating investor protections with the managers in light of that advice."

(From DB and DC investment governance guidance 2019)

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