PSIT Independent Trustees

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Governance & compliance: it's all about proportionality

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Being a pension trustee is no small task. Ask any trustee and, whether they are member nominated, company appointed or a 'day job' professional, they will tell you there are **three key areas of concern** to them and their scheme:

- legislative changes, governance and the cost of compliance
- funding - especially the relationship with and support from the scheme sponsor
- investment strategy and de-risking

Sometimes it is hard to know where one of these stops and the next starts. They are all interlinked, which makes things complicated. As trustees strive to manage all their scheme issues, I'm concerned that **the concept of proportionality in being forgotten**.

The compliance burden makes proportionality impossible, right?

On The Pensions Regulator's (TPR) website there are currently 20 regulatory guidance documents, 11 codes of practice and 7 sets of code related guidance. So, **up to 40 key regulatory documents trustees need to be familiar with** - and that's before trustee knowledge and understanding requirements, learning resources, guides…

Scheme advisers are certainly there to help decipher the multitude of requirements, formulate plans of action for a scheme and help keep the trustees they advise on the straight and narrow. However, despite the best of intentions, **advisers can also lose sight of proportionality** in the desire to deliver the 'best advice'. I think this sums up the dilemma.

The compliance burden **makes proportionality difficult...** but the desire to do the right thing and the significant pressures on time that trustees face **can make it feel impossible.**

What does proportionality mean in practice?

That's the million dollar question.

TPR believes proportionality is the reason why small schemes will not necessarily face additional costs when new regulations are introduced and is a theme it keeps coming back to; but it is not a black and white concept. Code of Practice 3 - Funding defined benefits is a good example, and it is worth reminding ourselves here what TPR says in the introduction to that code.

Factors that trustees should take into account in deciding what is proportionate for their scheme include:

- the **size** of the scheme (both in absolute terms and its size relative to the size of the sponsoring employer) and the strength of the employer **covenant**
- the **funding level** of the scheme
- the complexity of the proposed investment strategy, the investment related **risks** undertaken and the reliance placed on the employer covenant
- the likelihood that employer covenant, investment or funding risks will **crystallise** and their impact if they do
- the potential **costs and benefits** of any proposed approach
- the **complexity** of scheme design and employer relationships (as, for example, with non-associated multi-employer schemes)

That's helpful, to a point, but it is like being told only the high level solution without any of the detail you actually need to implement it. Maybe some examples would help.

Example 1

Employer covenant

It is easy to believe that an in depth covenant review is needed to assist the trustees in meeting several regulatory requirements, including those relating to funding and integrated risk management. However, such a review could represent a **big expenditure** and, for smaller schemes in particular, they **may not add much value**.

The information received from the review may not provide a great deal more insight than can be gained from informed, common sense interpretation of financial information available from, and discussions with, the sponsoring employer. In this situation it may be **more valuable to seek an additional contribution** from the employer than spend money on a covenant review.

Example 2

Efficiency

For small schemes, or where an employer has multiple arrangements, the **traditional model** where a scheme has its own board of trustees and set of advisers **can be** a **sub-optimal** form of scheme management:

- Appointing a sole corporate trustee can increase efficiency with the employer **making cost savings** (but not losing control) and members benefiting from independent oversight. For some clients, one trustee meeting a year with an employer representative may be all that is needed, as the trustee handles routine scheme management and governance.
- For multiple arrangements with the same sponsoring employer, commonality across trustees and advisers can be beneficial. However, the real efficiency gains are achieved by holding combined meetings, either in part or in full. This **saves significant time** and fees, as trustees, their secretary and advisers only need to prepare for and attend one rather than multiple meetings.

Example 3

DC governance

Following the release of TPR's code of practice on the governance of trust-based defined contribution (DC) schemes, consultants were quick to offer solutions to help trustees ensure compliance. Most of these included comprehensive consultancy advice, which is fine for a large DC scheme but may not be proportionate for smaller schemes or those where additional voluntary contributions (AVCs) are the only DC benefits.

For one client, who had a very new and very small DC section, we took a different approach. We undertook an assessment using the template provided by TPR but improved the presentation to **make it easier** for the trustees to understand and use the results and recommendations. The result was full compliance with the new regulations at a fraction of the cost quoted to the trustees by their consultant.

Proportionality is achievable, even for small pension schemes, but to do so trustees need to **take time, step back from the detail and consider the bigger picture**. They also need to keep on top of their advisers and **be quizzical** about the scope and depth of advice or services being suggested, checking if things are really needed and, most importantly, whether they will **add sufficient value**.

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