

21st-century trusteeship

Not past their use-by date yet

A number of industry experts are suggesting that the rise of the independent trustee means their member- and employer-nominated colleagues have had their day. We look at what the lay trustee still has to offer



by: Sara Benwell

For almost a decade, most pension schemes have had a legal requirement to ensure that at least a third of trustees (or directors of the trustee company) are member nominated. But in an industry ravaged by frequent and fundamental legislation changes, there are concerns as to whether lay trustees still have a meaningful role to play.

The Pensions Regulator's recent research suggested that boards that included independent trustees tend to be better governed, have superior training in place and were more able to challenge advisers in an appropriate way.

These results, alongside the steady decline in defined benefit schemes and the rise of sole trusteeship, have left some industry experts questioning whether member- and employer-nominated trustees should continue to play a part in the future governance of schemes.

But are they right to? We take a look at what MNTs bring to the table and what challenges they must overcome if they are to fit with TPR's concept of a 21st-century trustee.

WHAT DOES A 21ST-CENTURY LAY TRUSTEE LOOK LIKE?

Those trust-based schemes with MNTs on their boards are adamant that they continue to add value. In particular, schemes identified five key areas where lay trustees are best placed to meet the needs of members.

1 Preserving the member's voice
Many MNTs are keen to stress the importance of making sure that members' interests continue to be protected and promoted on trustee boards.

Tim Sharp, a policy officer at the Trade Union Congress, explains: "An understanding of the member is the obvious thing. Lay trustees are the connection between the pension scheme and those who will benefit

from it. Professional trustees may be skilled individuals but what they may be missing is that deep understanding of the workforce and what their priorities might be."

Jeni Goodchild, head of trustee governance at RMPI, says: "Our trustees spend quite a lot of time with their finger on the pulse of their membership because they see that as a key part of their job. All trustees, including our pensioner members and the trade union representatives, visit branches across the country. And they'll give presentations or they'll answer questions."

In defined benefit this is crucial. As schemes navigate the journey to full

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funding, decisions must be made about possible increases to employer contributions. It is important that members' interests are protected and employers are held to account.

Sarah Smart, chair of the trustee board at The Pensions Trust, asks whether independent trustees alone can adequately reflect the members' opinions. "Do independent trustees really get the members' voice heard effectively or – given that they're selected and paid by the employer – is it too much in their interest to keep the employer happy?"

On the defined contribution side, broad member bases and the increasing number of decisions that need to be made at the point of retirement mean trustees play a vital

role in providing trustee boards with a joined-up view of what members want. This is more essential in a world where members – rather than employers – bear the majority of the investment risk.

Smart however, sees potential issues ahead: "The challenge for DC, particularly in a trust-based world, will be that trustees have a duty to work in the members' best interests, not to do what the members want."

2 Remembering what pension schemes are for

Part of representing the member on a board is reminding the trustee board what it is there for, argues Goodchild.

"Pension schemes are all about paying benefits to members and we can all sit as experts having interesting discussions about investment strategy or pensions policy, but if we forget that actually what we're there for is to pay member benefits, then we might as well all go home," she says.

"It's not an academic exercise in investment management."

3 Communications – but not just communications

The trustee landscape research found that one area where lay trustees really shine is communications.

Barry Parr, co-chair of the Association of Member-Nominated Trustees, says: "In a world of second-pillar occupational trusts run by most reputable sponsoring employers, then MNTs have proved to be a valuable and perhaps essential element in both protecting members' pension pots and in bridging the communications gap between members and pensions professionals.

"It would be a mistake to write off the potential that MNTs bring to member understanding, and the soft influence that they have on member take-up and exploitation of pension opportunities."

Andrew Warwick-Thompson, executive director for regulatory policy at the Pensions Regulator, is >>

OTHER WAYS OF GETTING THE MEMBER VOICE HEARD

MNTs are not the only way of making sure that members get their voice heard. The Pensions Trust, for example, holds annual webinars for members so they can question the trustees about how the scheme is governed.

Depending on the size of the scheme, and the budget the employer has available, there are a number of things that schemes can do:

- > **HOLD AGMS** – this allows members to air their concerns, although it is important to ensure that meetings are not dominated by a few people who may not have the same interests as the membership in general
- > **WEBINARS** – these allow you to screen questions in advance, picking the most popular ones to be answered. It also means members can watch either live or in their own time
- > **ROADSHOWS** – these can be expensive but for a spread-out membership can give people a face-to-face opportunity to discuss the scheme and any worries
- > **OPENING DIRECT LINES OF COMMUNICATION** – this can be giving members access to the trustee board as a whole or specifically their member representatives
- > **SURVEYS AND RESEARCH** – whether qualitative research or email surveys, this can be a cost-effective way of gathering member opinion

» keen to stress that communications should not be the only role of MNTs.

“There’s a slight danger that they just become messengers and they’re not really having the opportunity to effect change.

“I think the emphasis needs to be that all trustees, whether they are professional, employer-nominated or member-nominated, have to act in the best interest of the beneficiaries. That’s a duty of all trustees. So I wouldn’t want to see MNTs just being relegated to a communications role.”

Smart agrees that MNTs are a useful part of the decision-making process. She says: “At the moment I have a 12-strong board and 10 of them are representatives. Do I find that challenging? Yes, I do. But is it helpful in some of the decision making that we take? Yes, it is.”

Goodchild is also keen to stress the importance of lay trustees in making decisions.

“It’s very important and they have a really valuable role to play. I think we’d lose something if we didn’t have the MNTs’ voice, not just to give views and opinions now and again but to be

really involved in the decision making of the scheme.”

She gives the example of when the Railways Pension Scheme was deciding whether or not to offer in-house drawdown solutions. Eventually it decided not to, mainly as a result of feedback from the lay trustees that there was no interest from members of the scheme.

4 Avoiding groupthink

One of the most important functions of MNTs, according to Sharp, is that they are instrumental in avoiding ‘groupthink’.

“Think about some of the key events in recent years, including the financial crisis which illustrated the risks of groupthink. One of the advantages when you have lay trustees involved is that there is somebody to ask the ‘why are we doing this?’ question,” he says.

Parr believes that this is one of the core tenets of lay trusteeship: “The role of MNTs on any scheme remain as hitherto – the same as for all the trustees – but equally there are particular attributes which MNTs

often bring to the table – a strong appreciation of the members’ positioning and effective communications with them, the willingness to challenge an adviser and perhaps even some sacrosanct presumptions and a keen interest in the security of assets – the future pensions of members.”

Warwick-Thompson agrees, but stresses that MNTs need adequate training to fulfil this function properly.

He says: “Where the training for MNTs or for any lay trustees is necessary is to give them the confidence to ask the ‘stupid question’, because very often that’s the one that breaks groupthink.

“Being trained and encouraged until you’re confident enough to ask stupid questions is a good thing.”

5 Keeping regulation simple

Sharp believes that another benefit of having lay trustees is that it removes the need for over-complicated regulation.

He explains: “You either have a group of people who are there to act in the interest of pension scheme members and that’s a way of keeping the process of running a pensions scheme honest, or you have to rely on regulators to come up with detailed rules about how things should operate.

“Experience tells us we’d rather have the former than the latter.”

WHAT ARE THE CHALLENGES TO 21ST CENTURY MNTS?

So it’s established that MNTs continue to add value to schemes, particularly when it comes to preserving the members’ voice and ensuring that the end goal of paying member benefits remains sacrosanct. However, MNTs will need to adapt to remain relevant.

1 Recruitment

Warwick-Thompson warns that recruitment issues may be more complex than they first appear.

He explains: “One of the things

“The training gives MNTs or any lay trustee the confidence to ask the stupid question”

that we expected to find was that the research would show people were finding it quite difficult to get MNTs involved.

“But actually we found that when answering that particular question, schemes, generally speaking, said: ‘No! We don’t have a problem getting MNTs, there’s no shortage of MNTs, we’ve plenty.’

“What was more alarming, though, when we poked into the answers to that particular question, was that a very high percentage of MNTs are actually senior managers in the business. So one has to question whether they are really MNTs or if they are ENTs and quite whether we’re getting the representation of the members’ voice that we’d hope to have.”

Smart says that she has heard anecdotally that schemes closed to future accrual can have real problems with recruitment, but that the Pensions Trust rarely has problems getting MNTs involved.

One solution, she suggests, is for smaller DB schemes to look to set up pooled arrangements like the Pensions Trust. She explains: “I would say that DB MNTs will fade away because over the long term we won’t have any DB schemes. So personally I think it will be increasingly challenging to have MNTs on DB schemes.

“That’s why I’d advocate a pooled structure... Organisations that have a DB scheme with the Pensions Trust don’t have to provide their own member-nominated trustees but anyone who is the member of a

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STYLE BENEFITS

Paul Myles, director at BMO Global Asset Management, discusses the potential of investment styles

BMO  Global Asset Management



A ‘style’ is a quantifiable characteristic of a group of stocks or bonds that determines the risk and return of that group. Some styles have been shown to generate positive long-term returns or ‘ premia’ both in extensive academic research and through their implementation within investment strategies. Examples of styles include value:

long ‘cheap stocks’ and short ‘expensive stocks’ and momentum: long past winners and short past losers.

WHY DO STYLES WORK?

Some argue that the positive returns are effectively a compensation for taking risk – this is very much an efficient market point of view. Others say that these returns are the result of behavioural biases in investors – like mistaking a good company for a good stock. Our view is that it is likely that both effects play a role. What is crucial though is that under each hypothesis the efficacy of styles will persist.

TAPPING INTO STYLES

In reality, investment styles rarely exist independently of each other. A perceived value stock for example may also be one whose price has fallen significantly and is therefore exhibiting poor momentum. Recognising this and considering the implications on potential returns, volatility and portfolio diversification, we have worked to develop a more effective way of systematically isolating individual styles into what we call ‘True Styles’.

APPLYING STYLES

We believe that there is scope for creating and deploying defined style exposures within a range of strategies. For instance, it might be appropriate to focus on the long-term outperformance potential of a specific style when aiming to outperform a regional equity benchmark. After all, ‘style’ exposure is often a significant component of ‘alpha’ within actively managed strategies.

The lower correlation exhibited between refined styles also increases the potential benefits of combining individual styles in a ‘multi-style’ format. For instance, styles can be utilised in a long-only structure with the aim of delivering relative outperformance or within a long/short strategy focused on the generation of absolute returns.

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» scheme in the Pensions Trust can put themselves forward if they like or they are reassured that other people have put themselves forward as member-nominated trustees.

"I think it makes it easier for schemes to retain that member voice with an ever-dwindling pool of people."

Sharp points out that the trade unions can help: "Trade unions play an important role in helping to develop MNTs. And often union activists are the type of engaged members of the workforce who are keen to take on roles such as being pension trustees."

Engagement is key, says Warwick-Thompson. He argues that the Regulator is particularly keen on lay trustees who are there because they are interested and want to be there, rather than just because it's their turn to put themselves forward.

2 Avoiding over-professionalisation

According to Warwick-Thompson, the Regulator is most focused on getting the balance of skills on trustees right, rather than forcing trustees to ever-higher professional standards.

He explains: "Nobody needs to understand how derivatives contracts work, you only need one member of the board to understand how a credit default swap works. We don't expect every single member of a trustee board to understand the minutiae of something that complex."

"Providing at least one trustee is able to understand and question the advisers and provide some challenges to the advisers on that kind of instrument then that's sufficient."

Goodchild thinks that over-professionalisation flies in the face of what MNTs are there to do.

"We have to be careful what we expect trustees to do. They have professional advisers, they have people who are there to tell them what the law is, how the funding works. The trustees' job is to question, to challenge, to push and to remind

THE THORNY ISSUE OF MASTERTRUSTS

Mastertrust governance has come under fire recently, particularly from the Pensions Regulator.

The TUC's Tim Sharp, worried about the possibility of scandal as smaller trusts fail over time, has suggested that MNTs could help. "It is important to have robust governance and that should involve a strong member presence, ideally in the forms of MNTs as well as employer representatives."

However, the Pension Regulator's Andrew Warwick-Thompson questions how realistic this would be, arguing that you can't have one MNT for each of the employers represented in, for instance, NEST.

NEST has introduced employer panels to ensure the members' voice is represented. However, Warwick-Thompson believes the next step is understanding how this feedback is channelled through the board.

"The levels of knowledge and understanding vary between categories of trustee"

everybody that it is all about the members, but when they take that advice and come up with decisions they should be entitled to rely on their advisers."

3 Getting employer buy-in One problem that many lay trustees have when it comes to getting the right levels of experience and knowledge is employers who begrudge them time out of the office.

This is something Smart has seen at the Pensions Trust, not just from

MNTs but also with their employer-nominated counterparts.

And RMPI's Goodchild argues that employers need to invest in their MNTs if a trust-based approach is going to work.

She says: "If an employer is going to have a trust-based scheme and it's going to nominate and appoint members to its trustee board or committee, then they need to recognise that there's a time commitment and they need to allow those people to do their job properly."

THE ROUTE AHEAD

Despite the challenges, the Pensions Regulator is keen to stress the continued importance of both member- and employer-nominated trustees.

Warwick-Thompson says: "There's a role for professional trustees, employee-nominated trustees and member-nominated trustees in all occupational schemes."

"It's certainly clear that the levels of knowledge and understanding vary between categories of trustee – trustee engagement varies, so I think that what we will be focusing on is the overall composition of the boards of all DC and DB schemes."

Better training methods will be crucial in smoothing the way forward and overcoming many of the challenges trustees are facing. It will also give lay trustees the right knowledge and understanding to allow the role to develop into a 21st-century solution.

Sharp warns, however, that while training is more important than ever for the future of lay trustees it must be used correctly.

"We should certainly not be complacent about where we are and it's important to keep looking at things like the skills and knowledge of trustees and training as tool for supporting them in their work, but certainly not as a stick to beat the trustee with, or as some sort of way of professionalisation by the back door." **E**