Trustee Governance Survey

May 2023

wtwco.com

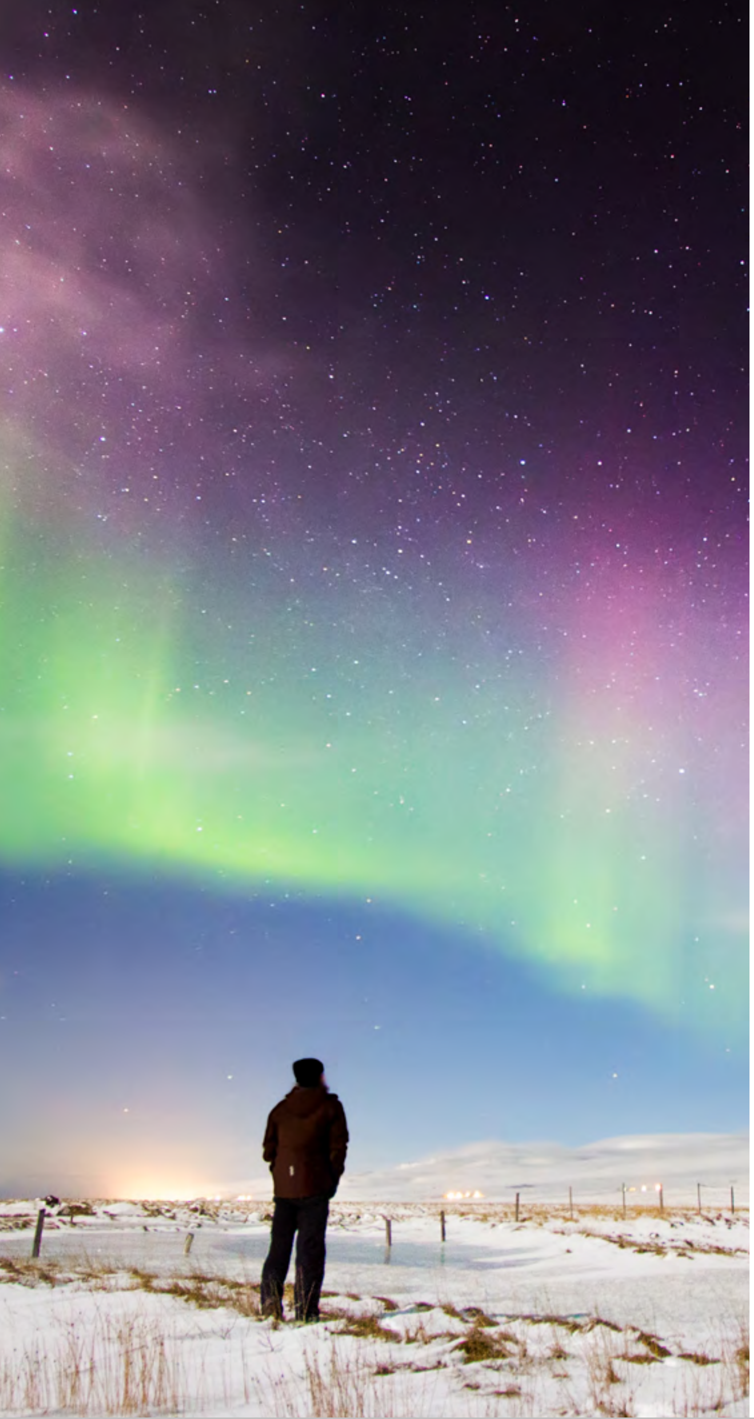


TABLE OF CONTENTS

Executive summary

Responding to the new General Code is the top governance priority for schemes.
The top priority for schemes is to address the Pension Regulator's (TPR's) new General Code.

Buyout is now closer for many schemes, and this is leading to changes to governance.
For around half of schemes preparation for settlement is now a major governance challenge, particularly for small and mid-sized schemes.

Most schemes are targeting a high standard for their governance.
Nearly all schemes (96%) are looking to more than just basic compliance with their governance: 78% are aiming for average or better than average and about 1 in 5 are looking to be best in class.

The introduction of the Risk Management Function will increase trustee resource requirements
In response to the expectations set out in TPR's General Code, most schemes expect responsibility for the Risk Management Function to fall to the full trustee board or a sub-committee, which may mean a material increase in resource requirements.

Trustee boards are taking significant steps on governance effectiveness.
Boards are reviewing their effectiveness more frequently – two-thirds are now running annual self-assessments and 3 in 10 are externally assessed at least every 3 years. And with 7 in 10 Boards already having reviewed their skills diversity, attention is now turning to demographic and cognitive diversity.

The focus on ESG widens.
Previously, we found the largest schemes were looking to increase their focus on ESG in investments in response to TCFD requirements. As these requirements have spread to mid-sized schemes, so has the focus on ESG. Yet even in smaller schemes, where it is not mandatory, 4 in 10 are recognising ESG as one of their key governance challenges.

The focus on cyber risk grows.
Whilst nearly 9 in 10 are confident of meeting the Regulator's expectations on data breach and incident response, only half are confident of having the skills and resources to manage their cyber risks. Schemes are looking to address this: for example, the annual training of trustees on cyber risk is expected to triple in the next two years.

Introduction

A year is a long time in the world of pensions. 2022 saw inflation continue to rise and in response bond yields rose, with the Bank of England tightening monetary policy. In September, a turbulent market reaction to the 'mini-Budget' led to government bond yields increasing sharply, which led to rapid declines in the value of LDI portfolios for some pension schemes. As the market tumult eased and schemes regrouped, governance has been a key area of reflection. Then for many schemes, the aftermath of the LDI crisis saw funding positions improve and the road to settlement is that much shorter, with preparation for buyout offering its own governance challenges.

Alongside these shifts, pension schemes started to plan for a major change in governance expectations: the Pensions Regulator's new General Code of practice. Consulted on in March 2021 and due to be published imminently, the new code looks to consolidate 10 of the 15 existing codes of practice. It also features new elements, including climate change and stewardship, alongside greater content on cyber controls and the maintenance of IT systems and risk management controls.

Alongside the General Code, we are also seeing other governance requirements related to schemes' investment strategies. In the UK, disclosures per the Task Force for Climate-Related Financial Disclosures (TCFD) framework became mandatory for the largest pension schemes (£5 billion or more of assets) in October 2021.

One year later (October 2022) this came into force for schemes with £1 billion of assets or more. In addition, the Department of Work and Pensions issued Guidance on Reporting on Stewardship (June 2022). This raises expectations on trustees' roles in stewardship activities, ideally covering both voting and engagement policies and further encourages focus on ESG.

Hence, with the increasing demands of scheme governance seen in recent years, the work of trustees has never looked so complex and there remain concerns about the ability to find suitable trustees, which is compounded by concerns Boards are not sufficiently diverse. In response, schemes are increasingly looking to take steps to address trustee recruitment issues.

Together this represents a challenging agenda for schemes and trustee boards. Against this backdrop, WTW surveyed 140 trustees, pension managers and other stakeholders during April 2023 on the future of governance of trust-based pension schemes and how the role of the trustee is evolving in the current environment.

The survey was conducted in early 2023 and includes 140 responses.

56% of trustees who responded chair their trustee board. A further 15% chair a subcommittee, with the remaining 29% not having either responsibility.

90 responses were from trustees (34 independent professional trustees; 30 company-nominated and 26 member nominated) and 50 responses were from either pension managers, trustee scheme secretaries or others in supporting roles.

Note: Most senior role mentioned. Don´t know responses excluded.

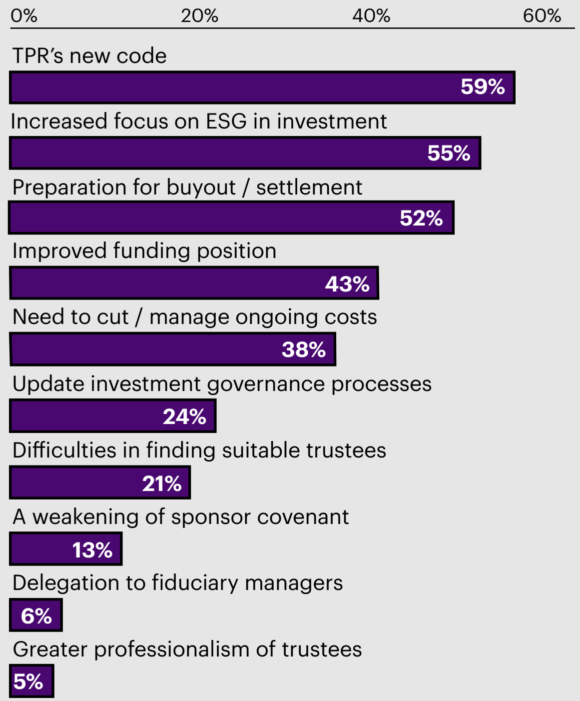
Key governance challenges

Figure 1 examines the key focus for pension scheme governance in 2023. Similar to last year's survey, the top priority for schemes is to address imminent expectations from the Regulator. TPR's new code is the foremost priority (59% of schemes), closely followed by an increased focus on ESG in investment (55%), in part driven by reporting requirement per the Task Force for Climate-Related Financial Disclosures (TCFD) framework.

Climate and ESG were a key priority last year for the largest schemes (£5 billion in assets or more), but this year they are rising up the agenda for mid-sized schemes (66% of schemes with £500 million to £5 billion in assets), and also represent a considerable focus for smaller schemes (39% of schemes with less than £500 million in assets), where formal disclosure requirements do not apply.

More broadly, the governance focus of schemes has shifted materially since 2022, with the movement in discount rates and improved funding for many leading to an increasing focus on the endgame of the DB journey rather than repairing deficits.

Figure 1: **Which of the following are the most important challenges for the governance of your scheme?**



Note: 16% for 'Other'.
Source: 2023 Trustee Governance Survey

Over half

of schemes believe preparation for settlement has become a top governance challenge

Preparation for settlement has become a top area of focus for over half of schemes (52%), particularly small and mid-sized schemes, with nearly 3 in 5 schemes with less than £5 billion in assets stating it was a major governance challenge, compared to around a quarter of the largest schemes. More generally improved funding (and what to do in a world of pension surplus, rather than deficit) is now the fourth governance priority (43%). Nevertheless, the need to manage costs is a priority for just over a third of schemes (38%).

Finally, amidst the seemingly continuous increase in governance expectations seen over the last five years and potentially a shrinking pool of members, 1 in 5 schemes (21%) report difficulties in finding suitable trustees as a major challenge. Though, as we will see later, many schemes are taking steps to address trustee recruitment issues.

The General Code

In March 2021, TPR published a draft of its combined code of practice. The new code's stated purpose is to consolidate 10 of the 15 existing codes of practice. Perhaps of greatest interest are the new elements. Unsurprisingly, these include matters such as climate change and stewardship, alongside greater content on cyber controls and the maintenance of IT systems. But new aspects of governance arising from the IORP Directive have also been incorporated, such as trustees' duties to:

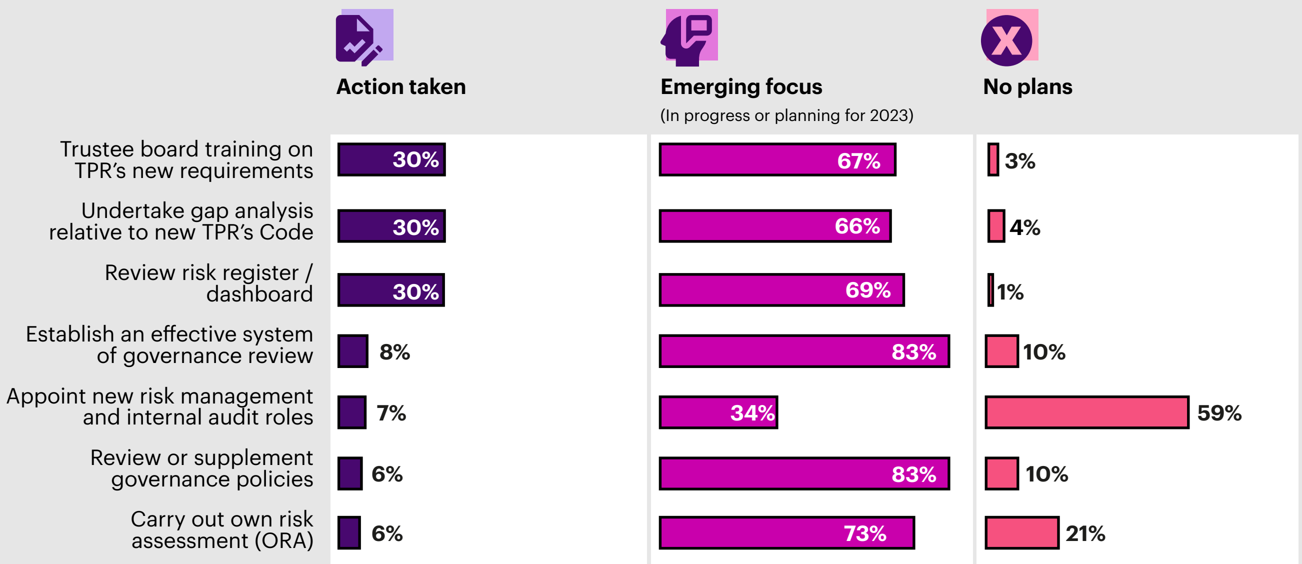
- Carry out an annual Own Risk Assessment
- Appoint a Risk Management Function and Internal Audit Function
- Put in place a number of additional formal policies

The combined code of practice was initially due to be released in 2022 but faced delays amid political upheaval and the Covid-19 pandemic.

In March 2023, TPR finally confirmed that the (now called) General Code will be published in Q1 of the regulatory year (which runs from 1 April 2023). Shortly after, we surveyed clients on their preparations for the General Code.

Schemes have already begun taking steps to prepare for the General Code with 3 in 10 schemes having already reviewed their risk register, undertaken gap analysis (to understand where the board's current governance arrangements stand relative to the expectations of the General Code) or carried out trustee training on the Code ***(Figure 2)***. The remainder of the schemes plan to complete such activities within the year, suggesting schemes will have a lot to do within a short time horizon.

Figure 2: **Does your scheme plan to do any of the following in 2023?**



Note: Observations were weighted to allow one single response per scheme. Numbers may not sum to 100% due to rounding.
Source: 2023 Trustee Governance Survey

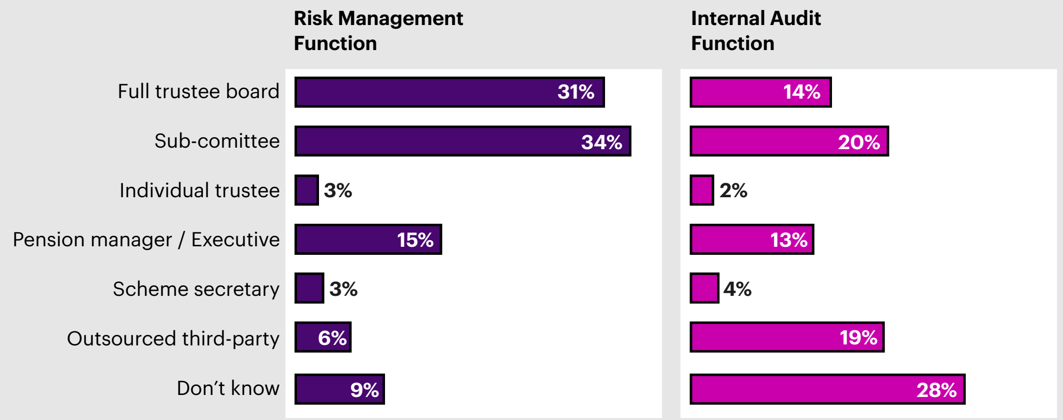
Preparations are somewhat more advanced amongst the largest schemes (£5 billion of assets or more) with 60% having undertaken a gap analysis, 38% having reviewed their risk register and 36% having completed trustee training on the Code.

Yet, whilst schemes have high ambitions, progress has been slow, as outside of these three areas (training, gap analysis, review risk register) little has been done to date. This is possibly not surprising, given caution on the final shape of the General Code. But it means the vast majority of schemes will now look to establish an Effective System of Governance (ESOG), appoint the new roles and review governance policies by the end of the year.

Less than 1 in 10 (7%) have appointed the new risk management and internal audit roles to date, 1 in 3 are planning to do so by the end of the year and 6 in 10 report no plans to do so. Given the Code says that these need to be in place for schemes with 100 members or more, clearly, some schemes are unclear on how best to tackle it.

In ***Figure 3***, we report how trustee boards are minded to assign the Risk Management Function and Internal Audit Function roles.

Figure 3: **Where do you expect the following roles to be assigned?**



Note: Numbers may not sum to 100% due to rounding.
Source: 2023 Trustee Governance Survey

Most schemes are looking to assign the new Risk Management Function (ultimately) to the trustee board (either directly or via a specialist sub-committee or an individual trustee), with a minority looking to sponsor resource (Pension manager/ Executive) and a small minority looking at an outsourced third party.

In *Figure 4* we can see how schemes of different sizes are looking to allocate these roles (ignoring the 'don't know' responses). Over half of the largest schemes (57%) are looking to resource the Risk Management Function within the Board, with most of the remainder looking to sponsor resource to meet the expectations. For mid-sized schemes, around three quarters (75%) are looking to the Trustee Board to fulfil this role, with only around 1 in 5 (18%) looking to sponsor resource. Finally, for smaller schemes, 4 in 5 (81%) will allocate the role to trustee resources.

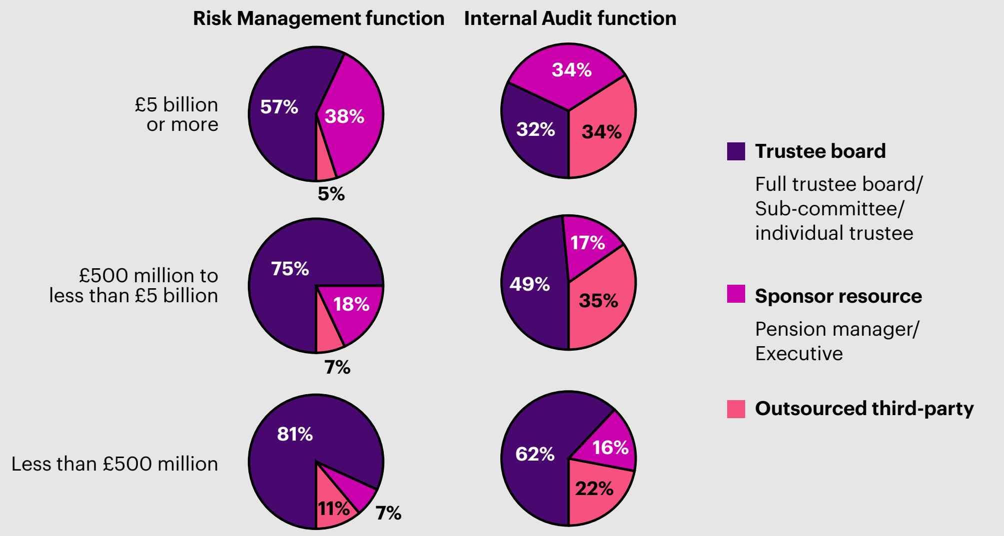
By contrast, for the Internal Audit Function there is some uncertainty as to where to allocate the role. There is a wide spread of responses across schemes, with just over a third looking to the trustee board to ultimately be responsible, just under a third looking to a sponsor resource or outsourced third parties to take up this responsibility and around 3 in 10 reporting they 'don't know'.

Ignoring the 'don't know' responses, the largest schemes are roughly equally likely to allocate the role to the Trustee Board (directly or via a specialist sub-committee or an individual trustee) (32%), to a sponsor resource (34%) or an outsourced third party (34%).

For mid-sized schemes, the respective figures are 49% to a trustee resource, 17% to a sponsor resource and 35% to an outsourced provider. For the smallest schemes, about 2 in 3 (62%) are looking to the Trustee Board to meet the obligations of the Internal Audit function, 16% to a sponsor resource and 22% to an outsourced provider.

Together these suggest, outside the very largest schemes, sponsor resource or outsourced third parties may only play a limited role in filling these roles, with material additional governance responsibilities falling to the trustee board. Moreover, noting the variation in responses and the number who 'don't know', there seems to be some confusion and difficulty in allocating the Internal Audit Function role.

Figure 4: **To the best of your knowledge, where do you expect the following roles to be assigned?**



Note: Numbers may not sum to 100% due to rounding. Scheme secretary is assigned half to Sponsor resource and half to Outsourced third party. Source: 2023 Trustee Governance Survey

Cyber risk

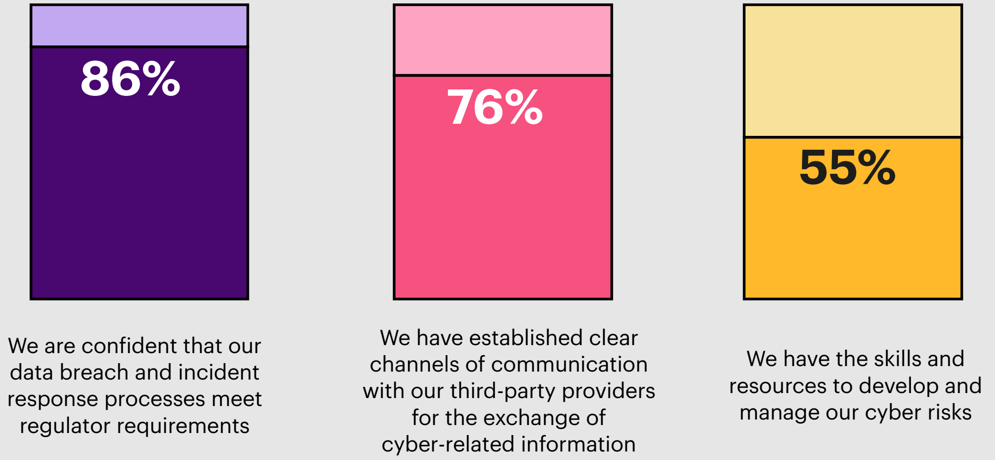
Over the last 5 years, cyber risk has risen to be one of the key risks organisations face. For pension schemes, the shift in attention to cyber risk has been somewhat slower but it's now becoming recognised as a key risk. The Pension Regulator (TPR) has included guidance around cyber risk in the General Code, which suggests all "pension scheme trustees need to take active steps to protect members and assets against cyber risk".

Where do schemes stand today on cyber risk? In ***Figure 5,*** we can see that a large majority of schemes (86%) feel they (will) meet TPR's expectations on cyber risk around data breach and incident response, while three quarters report they have developed clear channels of communication with their third-party providers on cyber-related information.

Only half are confident the scheme has the right skills and resources to manage the cyber risks they face.

Whilst schemes are confident these basic building blocks are or will be in place, fewer (55%) are confident their scheme has the right skills and resources to manage the cyber risks they face. There appears to be a recognition that, while they may be doing enough to satisfy the Regulator's expectations, to truly manage cyber risk more than basic compliance may need to be done.

Figure 5: **How strongly do you disagree or agree with the following statements about how the scheme is managing its cyber risk? % agree**

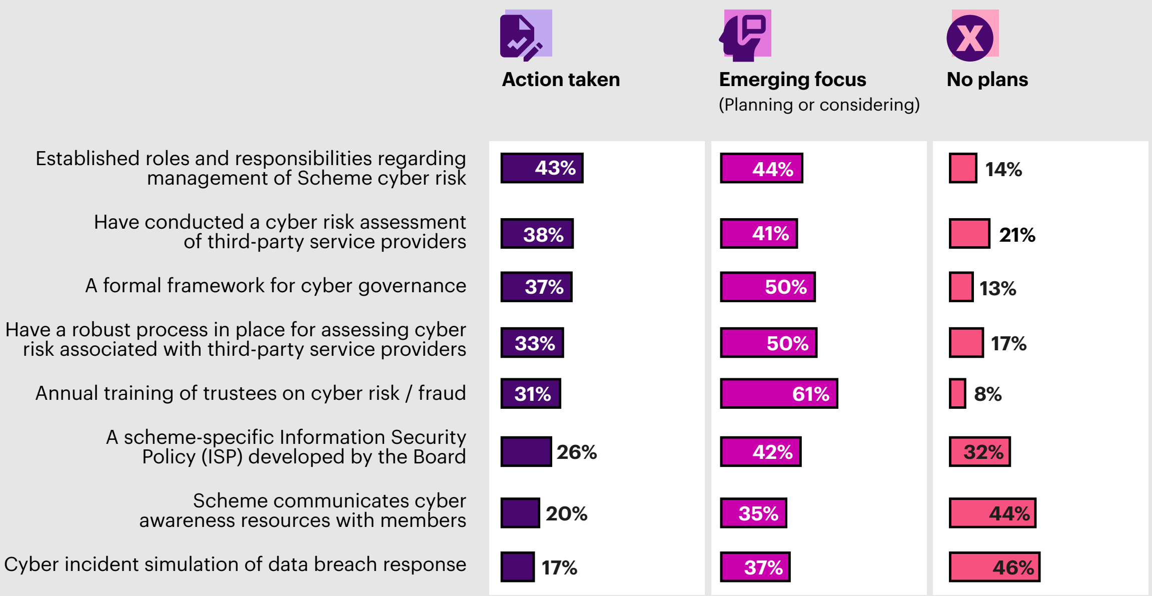


Note: Percentages indicate 'Agree' or ´Strongly agree'
Source: 2023 Trustee Governance Survey

In ***Figure 6,*** we report the steps schemes are taking to better manage their cyber risks. To date, most activity has been around establishing roles and responsibilities regarding the management of the Scheme's cyber risk (43%) and this figure may double in the next two years (44% are planning or considering doing so). Assessing third-party risk has also been a key initial focus, with cyber risk assessments of third-party providers having been completed by 38% of schemes and are planned or considered by a further 41%.

Annual training of trustees on cyber risk could triple in the next 2 years

Figure 6: **Which of the following does your scheme have in place, or does it plan to implement in the next two years, to manage its cyber risk?**



Note: Observations were weighted to allow one single response per scheme. Numbers may not sum to 100% due to rounding.
Source: 2023 Trustee Governance Survey

Formalising policies and procedures has been the secondary area of focus. Just over a third of schemes have developed a formal framework for cyber governance (37%), but a further 50% are looking to do so in the next two years. While a quarter of schemes have already developed a scheme-specific Information Security Policy (ISP), a further 42% are planning to or considering doing so.

Two further areas are expected to see rapid growth: trustee training and cyber incident simulations.

Trustee training that promotes broader knowledge and understanding within the trustee board on the cyber risks they face has been completed recently by nearly a third of schemes (31%) with 61% planning or considering doing so in the near future.

In addition, given the growing awareness of the risks of cyber-attack, we can see an increasing interest in how schemes respond to cyber incidents and breach response preparedness. To date, less than 1 in 5 schemes (17%) have undertaken a cyber incident simulation, but this could nearly treble, with a further 37% planning or considering doing so in the next two years.

Trustee workload

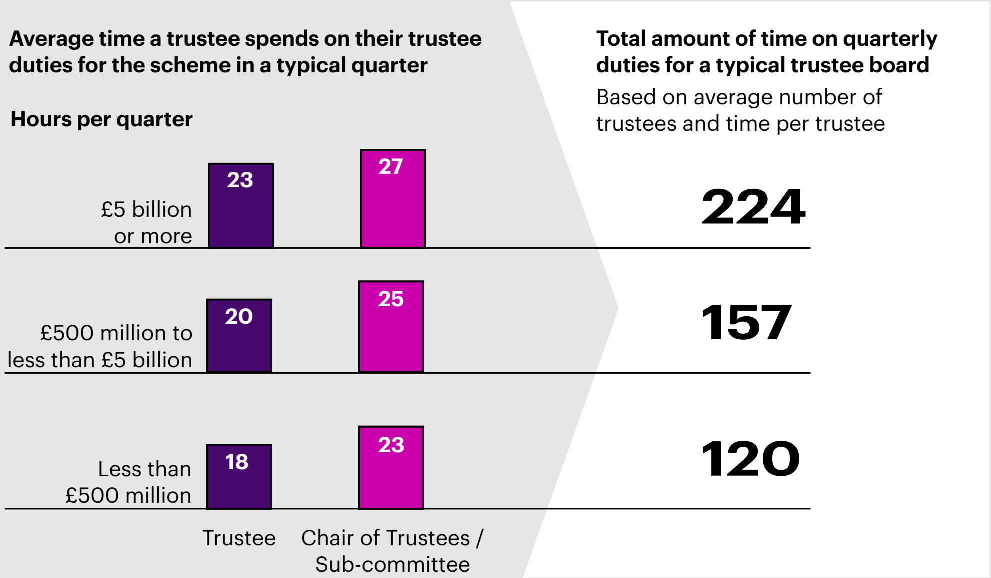
What is the typical workload for a trustee? In last year's survey, we examined the time taken on governance activities. In this year's survey, we examine the total time spent on all trustee duties ***(Figure 7).***

For a chair of trustees or the chair of a sub-committee, the average time commitment related to the management of the scheme is estimated to be just over 24 hours per quarter. For a regular trustee, this is 19 hours.

But these figures hide some variation according to the size of the scheme, with the trustees of large schemes expending more time on their duties. A chair of trustees or chair of a sub-committee of the largest schemes spend approximately 27 hours per quarter on the management of the scheme, compared to 23 hours per quarter for a similar role in small schemes. A regular trustee of a small scheme will spend 18 hours per quarter on their duties on average, compared to 23 hours for a similar trustee in the larger schemes.

Across a trustee board, these figures imply a significant investment of time. For smaller schemes (less than £500 million in assets), this would equate to around 120 hours per quarter for a full board. For schemes with assets between £500 million and less than £5 billion we estimate around 160 hours per quarter. Finally, for the largest schemes (£5 billion or more of assets), this climbs to around 225 hours per quarter.

Figure 7: **Trustee boards of the largest schemes spend 220 hours per quarter fulfilling their trustee duties**



Sample: Trustees only. 'Don´t know' responses excluded.
Note: Average is estimated based on mid-point of hours and multivariate analysis accounting for size of scheme and role.
Source: 2023 Trustee Governance Survey

Not only is there a significant time commitment to being a trustee, but it is also often said that the role of trustee has never been more complex, as myriad governance initiatives raise expectations and extend the scope of responsibility for trustees. Indeed 82% of trustee respondents in the survey reported that “the role of trustee has significantly more risk attached to it”, compared to 73% in 2021 and 76% in 2022. While 74% of trustees report their role has become more difficult (compared to 65% in 2021 and 69% in 2022).

Though our data does point to one way to reduce the burden on trustees: add an Independent Professional Trustee (IPT). Those who have an IPT on their Board were 15% less likely to report that their role as a trustee has become more difficult.

74%

of trustees report their role has become more difficult

Trustee board recruitment and diversity

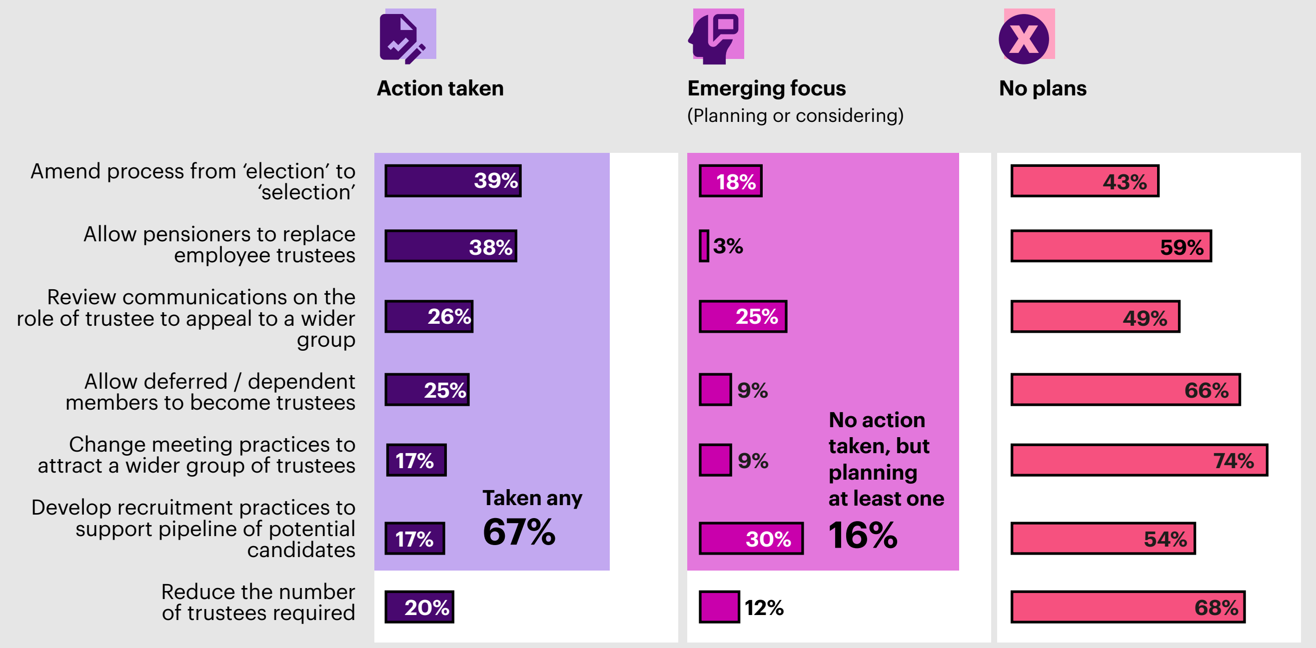
Trustee recruitment

The rising complexity, heavy workload and shrinking membership of many schemes is having consequences for trustee recruitment. In 2023 73% of trustees report that "it is becoming harder to find members to act as trustees", compared to 67% in 2022 and 64% a year earlier. Not only that, but schemes are also being encouraged to ensure a greater diversity of trustees.

In ***Figure 8,*** we can see that schemes are taking significant actions to address trustee recruitment issues. Two-thirds of schemes have taken at least one action to address recruitment (excluding reducing the number of trustees) and a further 16% are looking to do so.

Chief among these has been to amend the process from election to selection (39% of schemes action taken, 18% considering or planned). This is expected to help encourage (a wider pool of) candidates to apply for the role and permits more objective success criteria. In line with the aim of encouraging more applications and from a wider pool of candidates, some 17% are developing practices to identify and encourage suitable individuals in advance – developing a pipeline of candidates for the future – and a further 30% are planning or considering doing so. In this way, schemes and sponsors are looking to become more proactive and less reactive in planning for appointing a new trustee.

Figure 8: **Has your scheme taken any of the following actions to address the composition of the trustee board?**



Note: Observations were weighted to allow one single response per scheme. Numbers may not sum to 100% due to rounding.
Source: 2023 Trustee Governance Survey

With the dwindling number of employee members in many schemes, lots of these are also looking to relax the conditions on who can be a trustee: 38% now allow pensioners to replace employee trustees and 25% allow deferred or dependant members to become trustees (3% and 9% planning or considering, respectively).

Others are looking to make the role of trustee more attractive, to appeal to a wider group. 26% of schemes have reviewed their communications and 17% have reviewed meeting practices with this intention (25% and 9% are planning or considering to, respectively).

Finally, 1 in 5 schemes have taken the step to reduce the number of trustees required and a further 12% are looking at this option. This may be because of trustee recruitment difficulties or seeking to streamline governance on the trustee board for example as schemes mature.

Diversity and decision-making

The topic of diversity and inclusion has been an area of keen discussion for corporations and pension schemes in recent years, with a focus on addressing imbalances in representation by gender, race, age, sexual orientation, disability, etc. Yet, for the pensions industry, the concept of diversity builds on earlier discussions around the benefits of diversity of thought, where having a diverse group of individuals with different ways of thinking and the ability to challenge "groupthink" may lead to more robust decision-making and ultimately better outcomes.

On 28 March 2023, The Pensions Regulator (TPR) published guidance to help improve equality, diversity and inclusion on trustee boards. In addition, the draft General Code makes reference to skills and experience diversity, particularly in the context of succession planning.

What steps are pension schemes taking to address these issues? We examine three lenses of diversity:

1. Skills and experience diversity (the breadth of those skills and experiences that lend themselves to aspects of pension scheme operations)
2. Demographic diversity (across the full range of protected characteristics: age, gender and ethnicity, but also socio-economic diversity, neurodiversity, sexual orientation, disability, religion, education, etc)
3. Behavioural or cognitive diversity (this looks at the way individuals think, behave and interact in a group and make decisions)

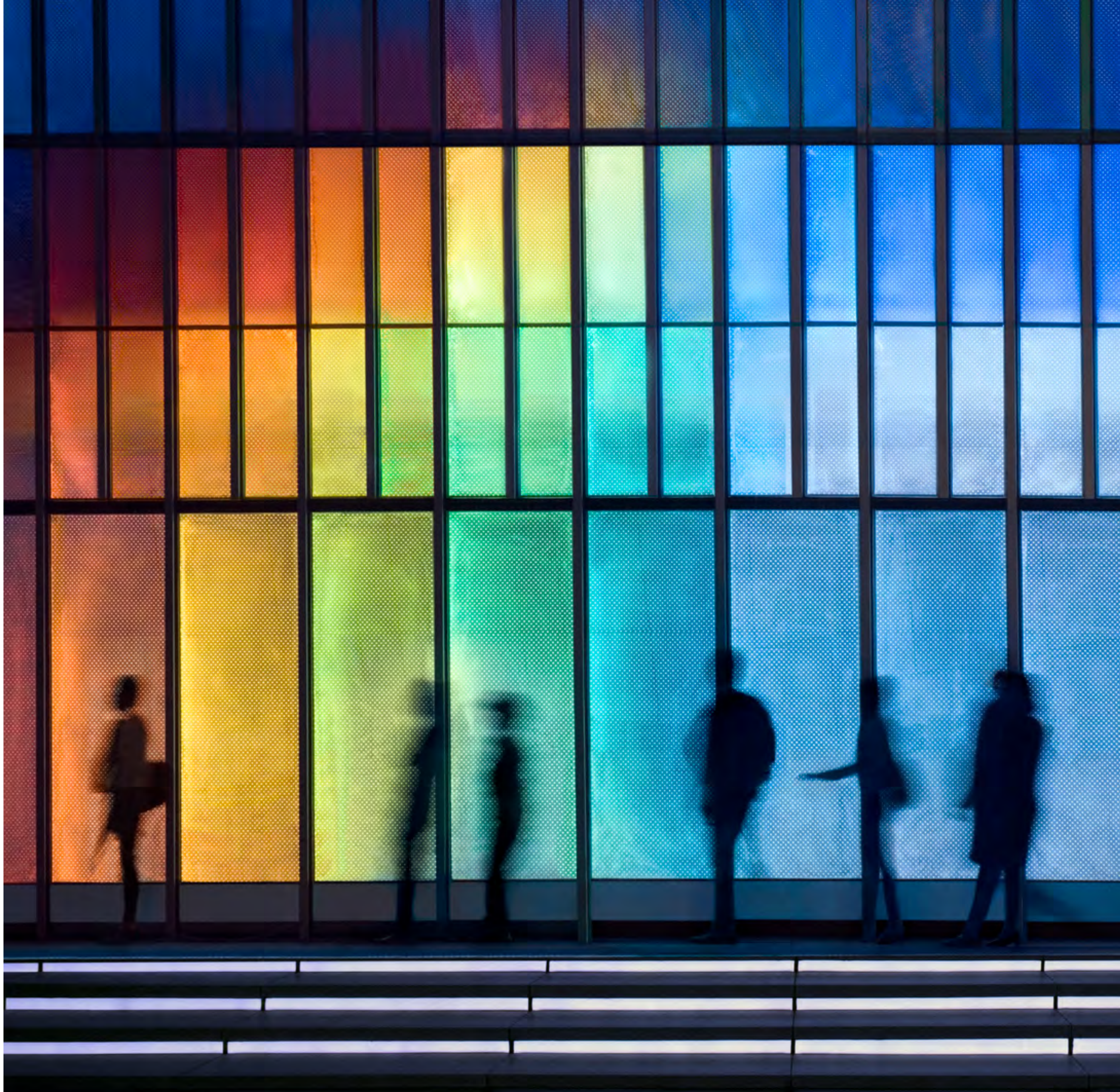
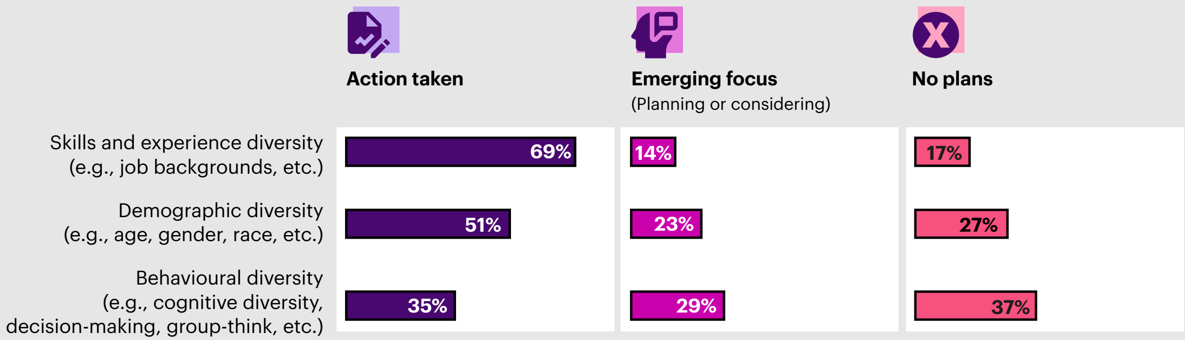


Figure 9: **Has the trustee board reviewed the diversity of the trustee board in any of the following dimensions?**



Note: Observations were weighted to allow one single response per scheme. Numbers may not sum to 100% due to rounding.
Source: 2023 Trustee Governance Survey

Our survey shows that schemes are getting to grips with the different lenses of diversity, but at different paces ***(Figure 9)***. Over two-thirds of schemes have already reviewed skills and experience diversity (69%); half demographic diversity (51%); and one-third behavioural diversity (35%).

And in terms of future intentions, 3 in 10 schemes are planning or considering reviewing their trustee board's behavioural diversity, almost a quarter are still planning to review their demographic diversity, and 14% are planning or considering reviewing the board's skills and experience diversity.

So, most trustee boards have already reviewed their skills diversity, but attention is now turning to decision-making and behaviours. Consistent with this focus on decision-making we also find that trustee boards are reviewing their effectiveness more frequently and are advancing from self-assessments to make greater use of independent reviews of board effectiveness. In our 2023 survey, some 66% of schemes assess their effectiveness every year (compared to 54% in 2021), with 3 in 10 seeking external input at least every 3 years.

If you would like to receive a full copy of the results or ask any questions on the themes covered by this survey, or wider governance topics, please contact your usual WTW consultant or:

Jenny Gibbons
Senior Director
Jenny.Gibbons@wtwco.com
+44 (0)1179 897 414

Catherine Ryder
Associate Director
Catherine.Ryder@wtwco.com
+44 (0)1737 274345

About WTW
At WTW (NASDAQ: WTW), we provide data-driven, insight-led solutions in the areas of people, risk and capital. Leveraging the global view and local expertise of our colleagues serving 140 countries and markets, we help you sharpen your strategy, enhance organisational resilience, motivate your workforce and maximise performance. Working shoulder to shoulder with you, we uncover opportunities for sustainable success — and provide perspective that moves you. Learn more at wtwco.com.

wtwco.com/social-media

WTW_104850_DB Governance Survey

wtwco.com