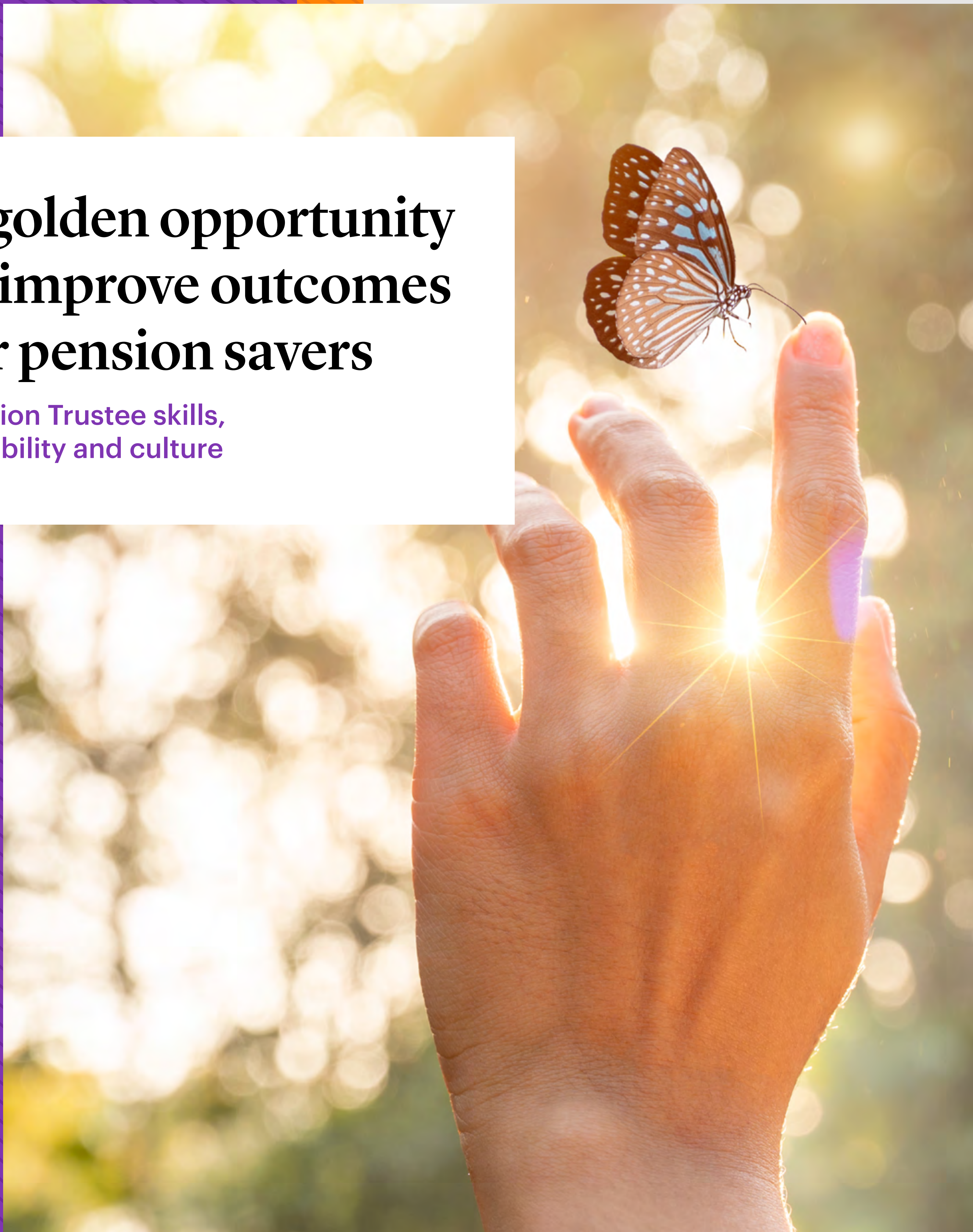
A golden opportunity to improve outcomes for pension savers

Pension Trustee skills, capability and culture



Pension trustee skills, capability and culture

Key policy questions

Whilst the Government is currently consulting on a broad range of issues related to the skills, capability and culture of pension trustees, the following are the most pertinent themes being explored in relation to its growth agenda:

- What role do and should trustees play in relation to investment decisions?
- How do trustees balance investment return decisions with other factors? Are they overly risk averse, particularly in relation to alternative asset classes?
- Are there barriers that restrict their ability to invest in productive assets?

WTW viewpoint in a nutshell

We do not believe that under-investment in productive finance assets is caused by a lack of knowledge and understanding amongst trustee boards. Based on our experience with our own clients, trusteeship is working well — albeit we have limited exposure to the large number of the very smallest schemes. We would be concerned that too narrow a focus on trustee understanding and knowledge of investment matters leads to unnecessary disruption of what is a strong and effective governance model.

Additional prompts to improve trustee board effectiveness more generally, such as those provided by TPR's General Code, are welcome and together with access to high quality advice, are a stronger determinant of good member outcomes than deep investment subject matter expertise.

The more likely and direct causes of under-investment in productive finance assets, in DB and DC schemes of different sizes, are addressed earlier in this paper.

Trusteeship is working well

WTW works with several hundred DB and DC trust-based schemes. The majority of these have trustee boards, whilst a number have sole trustees in place. Our experience across the spectrum is that the governance of these schemes is good. Too narrow a focus on investment expertise within trustee boards risks disrupting this well-functioning system.

A key to effective governance is clear dividing lines between advisers, who advise, and trustees, who crucially make decisions in the best interests of members, taking into account the advice they have received. The existence of and clarity over these dividing lines must be maintained even if increased investment expertise is added to trustee boards.

We recognise that there are some concerns about trustee skills and capability for the smallest schemes, and our experience of working with such schemes is relatively limited. As noted earlier, there are approximately 1,800 DB schemes with fewer than 100 members, and less than 1% of these are WTW clients. Consolidation of these smallest schemes is desirable from a governance perspective, but has real practical challenges, as discussed earlier and will not make any significant contribution to increasing investment in productive finance assets.

Where the scheme is governed by a trustee board, we find that the effectiveness of the board is down to the mix of skillsets amongst the board combined with an inclusive culture. Trustee boards are stronger where the set of skills is diverse. It is not necessary or desirable for every trustee to be an investment expert.

More broadly, we consider that the skills and experience of trustees are more important to their effectiveness as trustees, rather than knowledge and understanding of particular subject matter. Indeed, there are examples of individuals in decision-making roles who have strong and dominant views based on their narrow field of expertise, which lead to decisions which are sub-optimal in the round. There is so much more to trustee effectiveness and member outcomes than investment capability.

There is a risk that the changes being considered, for example through an accreditation regime that is too onerous or too wide, could disrupt the current trustee model from working effectively by reducing the diversity of skills and experiences. Trustees who may not have deep subject matter expertise in some fields bring a perspective that supports important decisions on a wide range of governance issues across communication, funding and administration.

DB: low-risk asset portfolios are not driven by trustee deficiencies

Investment returns targeted by schemes and their trustees are primarily driven by their funding objectives. Because funding levels are much improved, schemes typically need to target relatively low returns to meet their objectives. Absent an incentive to target surpluses, this has led them to de-risk, moving out of growth assets (including productive finance assets).

Indeed, many schemes are reducing their investments in illiquid assets as preparation for buyout, which is in sharp contrast to the Government's objectives.

In our experience, it is these factors, and not deficiencies in trustee knowledge and capabilities, that lead to what may be regarded as lower risk asset portfolios than might be seen in other jurisdictions. Taking into account their growth and liquidity targets, and a desire for diversification within their growth portfolios, trustees make sensible allocations to alternative asset classes.

Looking at the different segments of the market, the very largest schemes hold the majority of UK DB pension assets, and are therefore the most relevant to the Government's productive finance ambitions. These schemes, in our experience, have very strong trustee boards as well as best in class advisory support. They are therefore very well-governed, and have the sophistication to access alternative asset classes in a variety of ways.

The mid-market is also well-governed, through a mix of trustee boards or sole trusteeships. It also has the means to access alternative asset classes, typically through fiduciary mandates and pooled funds.

The small end is very fragmented and could benefit from some degree of consolidation, in order to improve scheme governance. As discussed earlier, multiple commercial consolidation providers and solutions should be encouraged, in order for the pension system to be able to cope with the operational burden of consolidating these schemes.

DC has different challenges with investing in unlisted equities, but it's still not a lack of trustee knowledge and understanding

The quality of trusteeship and governance effectiveness for large DC schemes and for master trusts is, in our experience, very high, and neither board effectiveness nor specific investment knowledge and understanding present a barrier to DC schemes investing in productive finance assets.

As discussed earlier, the biggest challenges with DC schemes investing in illiquid assets is the need for daily dealing and the higher associated costs, in an environment where currently value for money is looked at through the lens of costs. Overcoming both challenges requires scale, and historically the very fragmented nature of DC schemes has meant that the scale has not existed.

Pension policy is helping address both of these challenges. It has encouraged DC schemes to consolidate, leading to fewer and larger schemes. Moreover, the value for money framework is being changed to focus on value, rather than cost.

The emergence of a smaller number of larger DC schemes and master trusts is then enabling innovation and investment in technology which will allow them to make a wider range of assets, including unlisted equities, available to members.

WTW's view is that there is huge scope for further innovation in this area. On our part, we are committed to leading the industry in developing new solutions.

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.

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