XPS Pensions Group

How well are DB pension schemes run?

Governance Survey

July 2019

XPS Pensions

Overview

Good risk management and governance are fundamental to a successful pension scheme. Earlier this year we carried out a survey of defined benefit (DB) schemes to understand how well schemes are engaging with the Pensions Regulator's (TPR's) governance and risk management expectations.

TPR is continuing its focus on driving up standards of governance with its recently launched consultation setting out aspirations for further reforming trusteeship and governance standards.

Our key findings were:

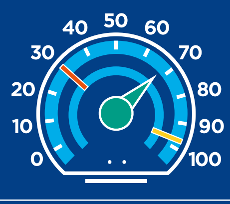
1. The quality of governance varied dramatically with scores ranging from **30 to 97 (out of 100)**. The average score was **69**, with the higher scores skewed towards larger schemes as might be expected. The scores imply that the vast majority of schemes have room for improvement. Indeed over two thirds of schemes surveyed achieved a score of **less than 75 out of 100**.

2. **Integrated risk management (IRM)** was one of the lowest scoring areas of the survey. IRM formed a fundamental part of the funding Code of Practice in 2014, but a number of schemes appear to have not yet fully embraced it. **Only 54% of respondents** said they understood the interactions between funding, covenant and investment risks and had an appropriate risk management framework in place. **22% of smaller schemes** agreed they 'hadn't really engaged with IRM'.

3. Despite substantial focus from TPR, pension scheme data remains an area of concern. **79% of schemes** had identified issues with member data. The majority of schemes had plans in place to improve data, but less than half were engaged with these plans and regularly monitoring them.

XPS Governance Score

We scored the responses in **5 areas** relative to the expectations set out by TPR in its 21st Century Trusteeship Campaign. Each responding scheme was then given an overall 'Governance Score' out of 100.



The **green dial** shows the average total score in each area. The **orange bar** show the minimum scores and the **yellow bar** shows the highest scores.

If you would like us to calculate your Governance Score and benchmark you against your peers please contact: robert.wallace@xpsgroup.com.

We had over 100 responses to the survey. Many thanks to all of those who took part. There was a good mix of schemes by size and clients and non-clients of XPS.

TPR has made it clear that it views strong governance as vital for achieving successful outcomes for scheme members. With TPR's expectations rising, our survey shows that there is plenty of room for improvement in governance standards across the board.

Rob Wallace
Head of Governance

Meeting effectiveness

Overall scores
in the meeting effectiveness section

Key

Average section total score | Minimum score | Highest score

A typical scheme has **4 trustee meetings** a year lasting **4 hours** each

More than half of schemes have 4 trustee meetings a year across all scheme sizes (although larger schemes make much more use of sub-committees). Meeting lengths ranged from 2 hours to a whopping 12 hours (hopefully spread over two days!).

20%

of schemes regularly don't discuss all the items on the agenda

30%

Only 30% of respondents from medium-sized schemes said all trustees were well prepared for meetings

XPS View

Most schemes scored well in this area and it appears that meetings are generally well run, with well-prepared trustees, open and constructive debate and a focus on the key strategic issues.

We would encourage trustees to reflect on how their meetings are run and whether there are aspects that could be done better. Trustee boards should also reflect on their own make-up. Do they have an appropriately diverse range of views and skills? Trustee effectiveness, both in terms of how meetings are run, and whether there are any gaps in knowledge, can be difficult to assess. There are a number of ways of doing this, including surveys, open debate and independent oversight.

6%

Only 6% think their scheme governance is worse than the average scheme

This self-assessment bias is perhaps not surprising, and is similar to the famous statistic that 93% of Americans think they are better-than-average drivers. However, there is an important point here in that many lay trustees will only have experience of one scheme and are therefore unable to compare what they do with other similar schemes. Guidance and support from advisers can be invaluable in improving standards, as can appointing an independent professional trustee.

Planning and decision making

Overall scores
in the planning and decision making section

Key
Average section total score — Minimum score — Highest score

34%

Only 34% of respondents usually make decisions quickly

Interestingly, the smallest and largest schemes were more likely to make decisions quickly, with mid-sized schemes being most likely to defer decisions and seek additional information.

22%

of respondents didn't agree with the statement 'we manage conflicts well'

Being aware of potential conflicts, and managing them, is an essential part of decision-making for all schemes. Only 60% of medium-sized schemes felt that employer-nominated trustees manage conflicts well. The highest score for this question was from smaller schemes with 84% agreeing.

> As a 21st century trustee, you must be aware of possible conflicts within your scheme.
>
> **The Pensions Regulator**

XPS View

Most schemes scored well in this area with only a handful of respondents scoring less than half marks.

Most respondents have a clear understanding of their advisers' role and agreed that their advisers provide clear recommendations, with very few saying that they typically follow advice without challenge.

Potential conflicts of interest are inherent within DB schemes, given that the key parties involved often wear numerous hats, eg company representative, trustee and member. They should not necessarily preclude an individual's involvement with the running of a scheme, but it is important for transparency and for a robust procedure to be in place.

However, managing conflicts of interest properly appears to be an issue for some schemes. If conflicts are not managed, then there is the potential for sub-optimal decisions to be made, or even for decisions to be deemed invalid. All schemes should have a clear policy and should document all potential conflicts each trustee and adviser has.

We believe that conflicts should be reviewed at the start of each meeting to record any new conflicts and to remind all parties of any conflicts that are relevant to the decisions that are to be made at that meeting. Where appropriate, we also encourage the use of independent trustees to assist with managing the inherent conflicts.

Integrated risk management

Overall scores
in the integrated risk management section

Key

Average section total score | Minimum score | Highest score

30%

of schemes scored less than half the maximum score in this section

13%

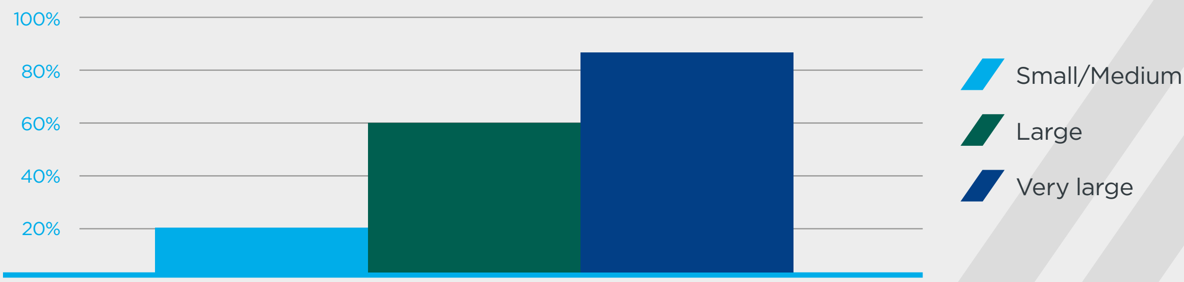
of schemes haven't engaged with IRM (22% for small schemes)

19%

Only 19% of schemes have legally enforceable contingency plans

Larger schemes are twice as likely to have a legally enforceable contingency plan, compared to smaller schemes.

% of schemes that receive at least an annual covenant update

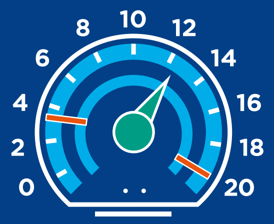


XPS View

IRM is a fundamental part of the scheme funding framework and has been a hot topic with TPR for a number of years. At XPS we think IRM is a valuable tool for creating a robust framework to get your scheme from where it is now to where you ultimately want it to be. We think schemes are using many of the aspects of IRM but perhaps the hardest part is integration, whereby the different risk factors are pulled together. Schemes can find it difficult to construct robust contingency plans as to what action you will take if certain scenarios unfold.

We believe that the first stage of a successful IRM plan is to understand the long-term objective for your scheme and your journey plan to get to that objective. IRM then helps you to analyse what might knock you off course along the way, how you can minimise the chance of that happening, and the actions you will take if you are knocked off course.

Funding and investment



Overall scores
in the funding and investment section

Key

Average section total score | Minimum score | Highest score

22%

Only 22% of schemes have a defined plan of action if the funding level falls (or doesn't increase as quickly as expected)

There were very different responses to this question by scheme size, with 48% of very large schemes having a clear plan but only 9% of small schemes.

18%

of the schemes surveyed completed their last triennial valuation outside of the 15-month deadline

TPR has publicly stated that schemes could be fined for late valuations.

79%

of trustee boards that use sub-committees have one that covers investment

The second most common sub-committee is administration, followed by covenant / funding / risk all with roughly equal numbers.

XPS View

There was a range of different scores for the questions in this area, albeit with a clear correlation between higher scores and increasing scheme size.

Scenario planning can help trustees to understand the factors that could result in poor outcomes, and also to plan for what action might be appropriate in different circumstances.

TPR has set out plans for two consultations in relation to scheme funding. The first will focus on options for a clearer framework for DB funding and the second on a revised Code of Practice. Trustees will need to follow developments in this area closely to ensure that they are making appropriate decisions.

Member data and communications

Overall scores
in the member data and communications section

Key

Average section total score | Minimum score | Highest score

57%

of schemes communicate with their members more than the statutory minimum

70%

of schemes have a plan in place to improve member data...

but only 42% regularly monitor progress against the plan.

35%

Only 35% of schemes seek feedback from members on the communications that are sent

62% of very large schemes seek feedback on communications, but less than 25% of small and medium-sized schemes do.

XPS View

Paying the right benefits to the right people at the right time is fundamental to pension schemes, and hence a pivotal part of the role of trustees. Theoretically this should be simple in the DB world where the benefits are clearly defined. However, DB pensions are incredibly complex when you have to allow for Guaranteed Minimum Pension (GMP), revaluation, equalisation, salary definitions and averaging, and adjustments for early or late retirement. The wealth of scheme documentation and overriding legislation complicates matters further.

As a result, around half of schemes have carried out an audit to ensure that historic benefit calculations are correct. Likewise, two-thirds of schemes review the accuracy of a member's data at the point of settlement, such as death, retirement or transfer out. This shows that a lot more can be done to ensure that data and calculations are correct before benefits are settled, because amending them afterwards can be difficult and costly.

The majority of schemes issue communications to members without seeking to obtain feedback. Trustees should consider whether the information that they are providing to members is understood, and accessible, and the easiest way to do this is to ask some of the members.

Recommendations

The survey results showed that there is a lot of good work going on within trustee boards. They did however highlight that many schemes could be doing a lot more to improve their governance to reduce risks within schemes and improve the chances of better member outcomes. As perhaps expected this is particularly true of smaller schemes, where costs and resources might tend to be more stretched – however, a number of smaller schemes had strong scores and are clearly taking governance seriously.

A robust governance framework does not have to be overly onerous. The main thing is to ensure that sufficient time is spent on important, strategic items and ensure that lower-level issues are delegated to those best placed to resolve them. Our four key recommendations are:

Increase focus on integrated risk management. Having a good understanding of the risks that the scheme is exposed to, how these risks interact, and the actions that can be taken to mitigate these risks is key to avoiding poor member outcomes.

Put in place a robust plan to **review member data and fix any issues**, with regular monitoring of progress.

Communicate with your members. Seek feedback, whether formally or informally, to help you to understand your members' concerns and improve the communications that you issue.

Make time within trustee meetings (or set up a sub-committee) to consider governance in more detail and assess honestly where improvements could be made. This should be an ongoing, regular process, rather than a one-off tick-box exercise.

> Good governance is the bedrock of a well-run pension scheme. Without good governance, you are unlikely to achieve good outcomes for members.

The Pensions Regulator, 21st Century Trusteeship Campaign

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About us

XPS Pensions Group is the largest pure pensions consultancy in the UK, specialising in actuarial, investment consulting and administration. The XPS Pensions Group business combines expertise, insight and technology to address the needs of over 1,000 pension schemes and their sponsoring employers on an ongoing and project basis. We undertake pensions administration for over 870,000 members and provide advisory services to schemes of all sizes including 25 with over £1bn of assets.

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