Pensions Management Institute

MTWG

Master Trust Working Group

Governance as a driver of member outcomes

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Introduction and summary

Dramatic expansions in the DC master trust market mean that more employers must choose between different master trusts. There are variances between the trusts available and employers may favour particular providers whose services they already use for administration or investment.

In this report we:

- Show that it is important for employers to focus on governance standards of trusts: because there is clear evidence that higher governance standards lead to better member outcomes.

- Provide some practical case studies and tools to assist employers in making governance distinctions between master trusts.

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Why does good governance matter?

Good governance is about effective decision-making – by the right people, at the right time and with the right information, and about holding those in charge of day to day management to account. Governance should be proactive, relevant and effective with robust systems and processes that deliver good saver outcomes.

For a DC master trust, key aspects of good governance involve:

- Operating in accordance with documented structures (tested and optimised), legal requirements and best practice standards.
- Articulating a delegation and decision-making framework so all those responsible for running the trust understand their role.
- Where appropriate, creating a boundary between the interests of the member and the interests of the master trust provider.

This demands a clear understanding of roles, responsibilities and accountabilities - and it requires the trustees and provider to have a clear strategic purpose and objectives. Some key examples of good governance are shown on page 3.

Pension scheme governance can draw lessons from the development of UK corporate governance. The green paper[1] which led to the current version of the UK Corporate Governance Code observed that corporate governance directly addresses the vital relationship of trust between businesses and the communities they serve. That relationship equally applies between pension schemes and their members.

Among pension schemes, DC master trusts are at the well governed end of the spectrum. The Pensions Regulator has publicly acknowledged this. But master trusts face an onus to continue meeting and strengthening their standards.

Strength in a changing landscape

Master trusts with high governance standards should be well placed for:

Successful times

Even during successful periods good governance is important: it is essential for any organisation to be able to exploit the opportunities open to it, and not lag behind its competitors. This requires trusts not just to respond to changes in regulatory policy, but also to be proactive during these periods to ensure better governance responses in more difficult times, for example through forward thinking scenario planning for stress scenarios such as cyber security breaches.

Difficult times

Organisations with good governance are able to adapt and respond in the face of shocks or crises. Studies show that corporate organisations with high governance standards weathered the 2008 financial crisis more effectively than their less well governed counterparts. The argument for pension schemes to foster similarly high standards of governance is that this will arm them to withstand crises, such as another Covid-19 epidemic or recession. This will support their members in achieving better long term outcomes.

Periods of change

Aside from major crises, the UK pensions landscape is still going through a dramatic change as a result of auto-enrolment. Good governance allows flexibility for trusts to be able to navigate these changes and choices for the benefit of their members. Some key examples are shown on page 3.

1 https://www.gov.uk/government/consultations/corporate-governance-reform

Features of good governance for DC master trusts

Amongst other characteristics, master trusts with high governance standards will:

- Put the right **structures and procedures** in place to enable effective, timely decisions, to provide clear scheme objectives and to appropriately identify, evaluate, and mitigate risk.
- Have **diverse trustee boards** and decision makers with the right skills, experience, qualities and capacity to run the pension scheme effectively in line with members' best interests.
- Process **core financial transactions** promptly and accurately.
- Ensure **systems and processes** are robust.
- Be prepared for **unforeseen events** to enable business continuity.
- Closely assess **value for members**, manage costs and charges, and disclose these effectively to members.
- Ensure **member data** is complete and accurate and is stored securely.
- Appropriately **communicate** with members and employers in the right format, with the right content at the right time and provide information to support members investment choices and retirement decisions.
- Hold **service providers** to account.
- **Continuously monitor and improve** the quality and impact of governance.

Good governance in periods of change: key current trends

- **Technology** is moving at a rapid pace, with online tools to manage money making traditional methods feel out-of-date, at the risk of alienating parts of the member population. For example, those schemes with good quality data will be better prepared for the age of the pensions dashboard and similar private sector initiatives.
- Approaches to **communications** differ, with some providers offering personalised videos at specific points in the saving lifecycle, calls for action at different life stages, or personalised online modelling tools.
- Providers offer different **decumulation** durations ranging from 3 to over 10 years and different funds to use as part of the decumulation phase. This shift can only work effectively if trusts understand what their members want.
- Thoughts on **investment** are diverse. Default strategies are often based around passive diversified growth type funds which try to balance the risk and reward for members with little volatility. Trustees must constantly keep their approach under review, with emerging developments such as the emphasis on ensuring ESG factors are integrated into investment decisions and the possible move towards alternative investments (such as private equity and debt, infrastructure etc) for large scale DC schemes over the coming years.

Good governance as a driver of better outcomes

What do we mean by 'better outcomes'?

Each employer will have its own aims for its DC scheme.

Many larger employers will want their pension scheme to:

- **Allow savers to build up a decent sized account**: The investment returns involved in this are a measurable form of member outcome, with comparisons easily available.
- **Allow some choice in how to access savings**: Well-constructed strategies aimed at helping savers access their money at and during retirement, and enabling them to make those decisions without too much stress and complication.
- **Give savers strong support**: Both while they are paying into the pension account, and later when they come to use their savings. This need to support pension savers well has become especially important because of Covid-19, which has led to increased scam activity and some savers' financial uncertainty and vulnerability.

Some of these are easier to measure than others, at least for the time being. An employer choosing a master trust will normally expect good outcomes for its employees in each of these three areas, among others.

So does good governance matter – does it improve outcomes?

Yes, all the signs are that it does.

This is firmly shown by statistical studies of defined contribution pension schemes. Those leave no doubt that improved governance leads to better outcomes for savers (see below).

But with the UK's DC market size growing so rapidly it's valuable to look for analogies in other walks of life, where organisations have already been through the same shift in size and complexity that master trusts are facing. These analogies cast light on the challenges that DC master trusts will encounter as their reach and responsibilities grow.

Some of the most interesting lessons are captured below.

DC pensions: the established statistical studies

Various pieces of research over the last 15 years have shown a clear link between the time and effort put into governance, and performance for pension savers. The research is helpfully synthesised in the PLSA's 2017 paper "Good governance – how to get there".

One of the research studies (Ambachtsheer, 2007) concludes that improved governance can generate, on average, an additional 1% to 2% per year investment return. For many pension savers that difference over a lifetime could amount to thousands of pounds.

DC master trusts: lessons from the Australian system

The Australian defined contribution market is about 30 years ahead of the UK, with the Australian "Supers" sometimes described as forerunners of the UK's master trusts. There is an interesting seam of recent reports from Australia, showing for example that governance factors such as board diversity and independence have an identifiable link to performance in some areas (Torunn Nisbet, 2013; McKell Institute, 2014).

In 2018 the Australian Institute of Superannuation Trustees (AIST) introduced a mandatory governance code, which in turn has led to imminent enhanced regulation (The Prudential Standard 515). The key principle behind the success of the code is that sound strategic and business planning is essential for driving improvements in outcomes for members.

Defined benefit pension schemes

An important analogy for DC master trusts comes from the UK's large defined benefit pension schemes. These hold multi-£bn pension benefits and have seen their asset size and governance structures grow over many years, in the same way that DC master trusts are now doing.

In the mature defined benefit sector long-standing experience shows that larger and better resourced funds are well placed to take steps that improve outcomes for their members, such as tailored investment arrangements designed to maximise returns without undue risk.

The health sector

There is an analogy with the UK's health sector where there is a strong acceptance that improved governance leads to better outcomes for patients. The NHS has adopted a range of comprehensive processes for ensuring good governance. These include requirements for a statutory board, internal audits, procedural guidance for staff, codes of conduct and accountability, and scrutiny by external assessors such as the Care Quality Commission. A 2010 report for the National Institute for Health Research Service Delivery and Organisation programme supported this focus, with the report showing a strong observed link between improved governance in NHS bodies and better outcomes for patients.

The education sector

Research shows that governance can affect outcomes for educational institutions and their students / pupils. The studies suggest that in-house knowledge is valuable on boards, and that committee structures should not be over-used – making the point that board design and governance must be tailored to the organisation and its needs.

The UK's Higher Education Code of Governance, for example, reflects this through its focus on quality of decision making, addressing the needs of all stakeholders and organising performance.

Experience in all these sectors shows that **improved outcomes result from better governance, and continue to do so the higher governance standards become**. Hence the strong imperative to focus on continuously improving governance standards.

Will the master trust authorisation regime guarantee good governance?

The Pensions Regulator's authorisation regime certainly is an essential element of governance for the master trust sector. The Regulator's supervisory approach focuses on the member first, recognising the importance of decisions by trustees and providers about the operation of the trust for members' outcomes.

But we're of the strong view that the authorisation regime should be seen as a minimum standard. Each master trust is free to set standards higher than the minimum. The key point is to appreciate the benefit that comes from this constant improvement of standards. We think any large employer looking for a master trust should focus on identifying the improvement.

Pages 7 to 12 below give examples of how trusts can achieve this – the nuances they can build in to take their standards above the minimum level. In other words, by identifying best practice rather than compliance, and recognising the benefits that best practice brings for savers.

What might good governance look like?

For large or medium sized employers, moving to a new pension scheme takes some work. Many put effort into market reviews and due diligence, costing money and taking up management time.

We're not suggesting that this time and effort needs to increase, only that the reviews should keep a very clear focus on governance as a key driver.

One way of looking at it: during an average 25 year old's lifetime, something like 7-8% of their pension contributions could go on fees for the provider. For someone whose pension contributions are £200 a month, that could easily be around £7,500 across their lifetime.

So it's worth putting focus into making sure your review leads to a trust whose governance is strong enough to give your employees a fair return on these charges.

But how should that focus be directed? What should you look for? How have some master trusts achieved best practice governance?

Pages 8 to 12 show some good examples.

The case studies are all mixtures of events we have seen in leading master trusts, rather than any of them relating to a particular trust.

CASE STUDY 1

Strengthening the member voice

A leading pension provider ran a strong, successful master trust. The provider and trustees were careful to seek member feedback, eg through member focus groups.

However, they wanted to go further and decided that they should recruit a trustee with specialist experience in retail communications.

The provider carried out a detailed search and identified a preferred candidate. After discussion with the trustees the candidate was appointed. The chosen candidate had a strong record of responsibility for consumer relations in financial services businesses, giving an extra dimension to the trustees' understanding of how to build and maintain savers' faith in the trust.

This strengthened the trustees in challenging the provider's communication strategy at every turn, leading to various small adjustments which enhanced the level of member support – especially for deferred members with small accounts, and younger active members.

Analysis

Even though the trust's member engagement strategy was already strong, the trustees and provider pushed themselves to continue making improvements. The decision to appoint a trustee with a specialist background was a bold step.

In doing this they recognised that they shouldn't make assumptions about members' priorities. They went out of their way to face some difficult questions. Some of those questions, which are relevant to all master trusts, include:

- **Are our members at the heart of our decision making?**
- **Do we know our members?**
- **Do we look at members across their life cycle, not just the run up to retirement?**
- **What outcomes do members want?**
- **Do we properly understand the trust's complex member demographic?**
- **Do all groups of members understand their options?**
- **Are members risk averse or open to risk?**
- **How do members access information?**
- **How do members take action?**
- **How do members want to be contacted about their retirement and when?**

CASE STUDY 2

A strategic focus

A master trust's board had an especially strong mix of skills and experience. They did a very good job of scrutinising the trust's operation and giving strategic input.

But, in common with other master trust boards, and despite the practical support already given by the trust provider, they found themselves reviewing an increasing volume of material, partly as a result of the Pensions Regulator's supervision regime. They were concerned that the amount of time they were required to devote to "business as usual" work might, if they were not careful, mean they didn't spend quite as much time on specialist strategic areas (climate risk strategy, the use of technology in member communications etc) as they would like to.

So they stepped outside their normal governance structures and creating working groups to focus on these strategic areas, composed of a mixture of trustees and in-house experts.

These working groups create a powerful framework for the trustees to engage fully with the various strategic areas, and with any that come up in the future.

Analysis

The trustees showed confidence by stepping away from their normal governance structures. They were proactive and bold enough to make this decision, and to move quickly given their concerns about the volume of activity.

They showed a fully co-operative approach with their provider, leading to a structure which enabled the trustees to obtain an even more responsive and tailored service from the provider's experts in the key strategic areas.

By doing so they helped to future proof the operation of the trust, ensuring its focus is not just on the "here and now" but the issues that will shape savers' experience in the future.

CASE STUDY 3

Board make-up and skills

A not-for-profit master trust performed strongly in its authorisation application and was well respected in the market, with an impressive mix of trustee skills.

With one of its trustees about to retire, the board carried out a skills analysis and identified that its operational knowledge (administration, IT, payment transactions etc) was not quite at the level it could be, and would be diminished by the upcoming retirement. So rather than an all-rounder, the board focused on finding this skill set for the newly appointed trustee.

Off the back of this review, the board decided to make its annual skills analysis even more granular than before, to protect against any possible or perceived weaknesses in specific areas.

Analysis

By taking these steps the board avoided a possible future risk.

The key point is not just that the trustees headed off the risk – but that they went on the front foot in building a process that guards against possible similar risks in the future.

Master trusts are required to maintain and update a skills matrix as part of the authorisation and supervision regime. But a really well governed trust will have effectiveness reviews that go beyond the regulatory requirement, and drill down closely into the trustees' skill set and succession planning. So it's important to ask how these board effectiveness processes work.

CASE STUDY 4

Resource and accountability

A commercial master trust had seen strong growth in the last few years. Various sections of the provider's in-house staff were involved in supporting the trustees.

The trustees received stewardship reports which were comprehensive but lengthy and provider-led, with limited narrative on how the provider was performing and the quality of service to members. The information was not tailored fully to the trustees' understanding of how their identified risks were being managed, for giving them assurance that their members' interests were being served or for holding the provider to account.

The trustees identified this and worked with the provider to adopt a matrix of internal accountabilities, to make sure that each internal reporting line worked effectively and gave the information they needed, tailored and presented for their review. In doing so they built a system which ensured that the provider's in-house teams were able to provide additional resource to enhance the level of support.

Analysis

The most valuable tool that a trustee board has in order to achieve high governance standards is effective reporting and monitoring.

Reporting should be focused on how trustees are / are not on track with their strategy to achieve their objectives. However, to assess this and provide assurances that operations are effectively functioning, providers are performing as they should be, and risks are being managed, trustees will need additional and tailored information from their service providers. Trustees should be clear on what information they need to see and what they will do with it and how, when and by whom issues should be escalated.

CASE STUDY 5

Risk management

A commercial master trust had a strong board, which understood that they were exposed to a range of risks from both internal and external factors. These risks were identified in the trustees' risk register which measured risks on a sliding scale.

However, the trustees recognised that in order for them to identify and evaluate risk, support from the provider was required. The provider supported the trustees by supplying a trustee risk manager, who was also experienced in supporting the provider's own risk management. The provider also presented management information to the trustee board and its risk management committees.

The provider operated multiple pension schemes including both trust and contract based schemes. Therefore, the provider operated its own risk management procedures which had a wider focus on operational and strategic risks which were outside of the risks evaluated by the trustees but nevertheless could affect member outcomes. For example, identifying and resolving issues that may arise as a result of the provider's overall profit and loss and capital requirements.

Analysis

The trustees and provider recognised that the risks to good member outcomes included both risks that are partly specific to the operation of the master trust (eg investment and administration) and from within the wider provider business, which could have a financial impact on members.

The provider therefore worked with the trustees to input into risk management procedures so that the trustees had full oversight, with the provider also keeping its own procedures in place to manage wider business risk. The trustees retained ultimate responsibility for the governance arrangements of the trust. In this case a co-operative approach led to strengthened outcomes for members.

Checklist for employers

These are the key questions that employers and third party evaluators can ask to compare governance standards between master trusts and extract meaningful responses for the benefit of their employees who will be moving into the trust. A well-run master trust should be able to answer all these questions convincingly.

1 / Knowing members

What level of member profiling do the trustees/provider carry out, either for the trust as a whole or for each section? Is this investment profiling alone, or also behavioural profiling?

What views do the trustees/provider have on the effectiveness of member feedback exercises, and what formats (surveys, focus groups etc) do they use? Can we see a copy / summary of the feedback?

How do the trustees make use of member feedback (eg in default fund design, member options and support etc)?

2 / Board effectiveness

How was the composition of the trustee board decided? What do the trustees and provider believe are the strengths and weaknesses of that structure? How is trustee effectiveness monitored?

What approach do the trustees (and, if applicable, the scheme strategist) take to diversity on the trustee board? Does the approach address diversity of thought or just personal characteristics?

How do the trustees make sure they give enough attention to strategic issues, alongside routine monitoring? What structures, if any, are in place for this (working groups etc) and what is the reason for using those structures?

How many times do the trustee board meet per year? How many training sessions have the trustee board undertaken over the past year and which topics have been covered?

What are the trustees' objectives for running the master trust?

3 / Risk management

How often are risks reviewed and who carries out this review? How is the risk register constructed and monitored? Is there a risk management committee? Do the trustees and provider share risk information?

4 / Resourcing

How are the trustees' needs resourced? Is there an executive team accountable to the trustees? If so, how does that team operate?

What measures are in place to make sure the resource will remain strong enough from one year to the next, especially as the trust grows?

Can the trustees or provider give an example of when resourcing was not at the level required? How was this resolved?

How do internal reporting or accountabilities work for the support provided to the trustees (eg one lead with overall executive responsibility; one member of the in house team accountable for each area, etc)? How and why was the decision made to use this structure?

5 / Interaction with the scheme strategist

How do the trustees and scheme strategist work together on business planning?

If the scheme strategist is not the trustees: can the trustees give an example of when they have challenged the scheme strategist on a strategic issue? How did they do this, and what was the outcome?

6 / Oversight of service providers

Are all service providers aware of trustee objectives and working to these?

What service level agreements do the trustees have in place with their service providers? What processes are in place to monitor these?

If the service provider is the commercial entity driving the trust, is there an escalation protocol and how does it work?

Can the trustees give an example of a case where they have had to address a weakness in a provider's service? How was this handled?

7 / Measuring member outcomes

Do the trustees have a definition of "good member outcomes" and/or a model in place for assessing member outcomes? What do the results of any such assessment show?

Do the trustees or provider review the outcomes members are achieving and benchmark them against peers? How are the less tangible areas (eg member support) benchmarked?

What has been the outcome of these reviews?

8 / Documentation

Have copies of the following documents been provided by the trust?

- Chair's statement
- Value for members assessment
- Statement of Investment Principles
- Master Trust Assurance Framework report
- Scheme booklets
- Any details of agreements in place between the provider and trustees that the trust is willing to share.

Please get in touch if you have any feedback on this report, or any suggestions for resources that you would like the PMI Master Trust Working Group to provide.

The aim of the PMI Master Trust Working Group is to provide a discussion forum for authorised UK master trusts to promote good service delivery and strong outcomes for master trusts' members.

The Master Trust Working Group has three workstreams: Governance, Training and Innovation. If you would like to join one of the workstreams or give any other feedback please contact

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