EVERSHEDS SUTHERLAND

The governance road map

Where are we going and what's next for governance?

With greater scrutiny of decision-making, increasing expectations of trustees and the promise of a tougher Regulator, the headlights are full beam on governance requirements for DB and DC plans. In this article we consider some of the key themes and developments in governance requirements for plans.

The governance journey generally

DB and DC pension plan governance has for a long time been seen as the road well-travelled and it's difficult to argue with that. However, with an increasing number of regulatory and legislative developments, there's no time to take the foot off the gas but you certainly need to know what's coming around the bend. To pick just a few bumps in the road...

DC consolidation

The Government has made it clear that smaller DC plans will be expected to consolidate where they cannot provide value for members. It is proposing that legislation will come into force on 5 October 2021 which requires trustees of DC plans that have been operating for at least 3 years and have assets of less than £100m to carry out a new 'value for members' assessment. The focus of the assessment will be on:

- charges and transaction costs borne by members
- the net returns on investments
- administration and governance

Factors such as the quality of plan governance, investment governance, managing conflicts and meeting trustee knowledge and understanding ("TKU") requirements will all be a key part of the assessment. This will require a significant amount of work for trustees, both in terms of carrying out the assessment and then being able to justify their particular conclusion.

Climate change and ESG

The Government is progressively increasing the obligations on trustees to take into account environment, social and governance ("ESG") factors when making and retaining investments. For almost a year now, trustees of defined benefit pension plans have been required to include in their statement of investment principles their policy on how they take 'financially material considerations' into account. These include ESG factors, with the legislation specifically including the effects of climate change as an ESG factor.

Provisions in the Pensions Schemes Bill, which is expected to become law later this year, are anticipated to see the introduction of further reporting requirements for trustees in relation to the governance they have around climate change risk. Trustees may be required to:

- review the plan's exposure to certain risks
- assess certain types of assets held by the plan (and determine their contribution to climate change)
- determine, review and (if necessary) revise a strategy and/or targets for managing the plan's exposure to certain risks
- measure performance against such targets
- prepare additional documents and publish information relating to the effects of climate change on the plan

Penalties of up to £50,000 could be imposed for breaching the new requirements.

In addition, the Department for Work and Pensions is consulting on climate change disclosures and non-statutory guidance for pension plan trustees on assessing, managing and reporting climate-related risks which we expect will sit alongside the new regulatory framework.

Increasing expectations of trustees

The Regulator's expectations of trustees are increasing. TKU requirements are likely to be revisited in the Regulator's proposed Super Code of Practice which we are expecting any day now, along with a TKU consultation and a regulatory initiative involving larger plans who have not adequately assessed and addressed TKU needs.

Already, there is more emphasis on how trustees meet a higher standard of ongoing learning and development and the growth in and popularity of accreditation programmes shows how seriously the industry is taking this.

The Regulator is not insisting on every plan having a professional trustee on its board, but it certainly seems to be the direction of travel.

In particular, the Regulator has made it clear it will revisit the potential requirement for professional trustees in the future if the quality of plan governance does not improve.

What should trustees be doing?

Trustees are in the driving seat when it comes to governance standards. Now is the time to carry out an in-depth, frank analysis of the plan's governance structures and consider how best you can prepare yourself for developments that lie ahead.

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