Learning from the other side: lessons from DB and DC Governance

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The governance of trust-based defined contribution (DC) and defined benefit (DB) arrangements has much in common. All trustees must oversee administration, investment and communications and ensure good governance through a motivated and engaged board, annual effective assessments and robust risk management. But there are of course key differences, not only due to the nature of the different types of pension arrangements, but also due to the differing development of governance regulations and guidance. Such differences (and the learnings that each can take from the other) did not play a significant role in the Regulator's recent consultation discussion paper on the future of governance. I take up that theme here...

DC Governance has exploded into life over the last five years, with the DC Code being a central focus around which trustees can assess the extent to which they are compliant with requirements. Additionally, many medium and larger size schemes have an ongoing DC Governance consultant supporting the trustees with this task, and in particular the legally required 'value for members' assessment and DC Chair Statement.

DB Governance is in a slightly different position. As yet, there is no 'DB Governance Code' (although the Pensions Regulator is currently reviewing and consolidating all its guidance), and as such DB Governance has a different profile. Even key new governance requirements like the DB Chair Statement have so far been trailblazed under a 'funding' umbrella rather than a governance one. Yet a central part of managing DB schemes is the important governance concept of Integrated Risk Management.

What DB can learn from DC

Given that the final details of the DB Chair Statement are yet to emerge, there is still time to hope that lessons can be learned from DC world. It is already clear the DB Chair Statement will not be subject to mandatory fining requirements by the underlying regulations, something that has turned the DC Chair Statement into more of a compliance piece than the original vision of a requirement that inspires good governance and communicates this to scheme members. Taking lessons from this, the DB Chair Statement should be a genuine governance document and not just a supplement to the triennial valuation paperwork. Like its DC counterpart it may benefit from:

- A requirement to consider the value for money provided by the scheme i.e. how member outcomes are ultimately being improved by the good governance and oversight provided by the trustees, and high-quality strategic advice; the current DC requirement which, in law, only requires assessment of services which members pay for ignores many factors which contribute to a high-value scheme for members such as the level of contributions, their ultimate expected outcome and benefits which the sponsor pays for, like great governance
- Meaningful narrative around governance quality such as training policies, approach to risk management and annual effectiveness assessment.

These are in addition to the clear focus on long-term objectives and approach to Integrated Risk Management (IRM) that all anticipate for inclusion. A central DB Governance Code, similar to that for DC, would also help to emphasise the importance of good governance for DB schemes, and draw together key themes such as trustee effectiveness (including diversity) and IRM.

What DC can learn from DB

Whilst DC Governance has in general advanced beyond specific requirements for DB, there is still much that DC can take from standard DB Governance. Two of these are the issues of covenant and triennial valuations. My colleague Rona Train raised the issue of covenant in DC in one of her recent blogs. What is meant by this? Surely, given no promised benefit, the strength of the sponsor in DC isn't so important? But there is a neglected issue here: what happens on sponsor insolvency for a company with a DC scheme that has no provision for wind-up expenses to be paid? The unpalatable truth is that expenses may need to be taken from individual member accounts. To avoid the risk of such an action, DC trustees should have regard for the sponsor strength and any signs that it may not be a going concern. They may also want to consider the matter further, in terms of gaining assurances that money has been put aside to deal with any such eventuality.

So that's covenant; how about valuations? Every DB scheme must undertake a valuation every three years to assess the funding level of the scheme and agree a recovery plan if necessary to repair any deficit. What could a 'valuation' concept mean in DC? When it comes down to it, what really matters in DC is member outcomes, which are extremely variable and critically dependent on members understanding a need to act over contributions, investment and retirement choices. Valuations in DC would therefore be valuations on the extent to which members are likely to obtain good outcomes based on their current scheme (and an appropriate allowance for service and benefits elsewhere). The results of such a valuation would support wider understanding amongst both sponsors and DC members of exactly what they can expect to get if they continue their current pattern of contributions and investment strategy.

The Future of trust-based Governance

The Pension Regulator's consultation on the future of Trusteeship and Governance has focused minds on issues such as trustee board composition (for example whether they are sufficiently diverse, or all require at least one professional), and trustee effectiveness and training. It has not however considered in detail the differences and learnings that the two major models of UK pension provision can take from each other.

> **Overall, we must be serious about the governance of our pension schemes. This requires a culture where both trusteeship and good governance are strongly valued.**

In such a culture, enough trustees will be found and 'hours counting' CPD will be unnecessary, as will constant regulatory intervention. Sponsors of pension schemes should see reputational risk around pension governance as a high priority and support their trustee boards appropriately. Good governance is about great trustees, strong secretarial and adviser support, and a willingness to adapt and learn from our collective experience to date.