Aon Hewitt
Retirement & Investment Solutions

Governance: Delivering Pensions Stability Faster

July 2015

Table of Contents

Synopsis

This paper summarises our research into pension scheme governance and delivery models. In previous thought pieces we have considered long-term aims and the financial tools that might be employed to reach Pensions Stability. In this document we consider how a pension scheme should be organised in order to get the best possible chance of carrying out the tasks necessary to reach that aim. In particular, it considers how governance generally, and processes specifically, can assist or distract defined benefit (DB) pension schemes in achieving their long-term objectives.

When asked about what keeps them awake at night, trustees and companies regularly cite issues such as lack of time, resources, knowledge and information. In other words, they worry about their collective ability, as individuals with responsibility for the pension scheme, to be able to make decisions and implement them effectively.

Such concerns are understandable. The issues facing pension schemes continue to expand and the requirements of regulators continue to grow. Making the right decisions gets increasingly important as DB schemes mature because as their cash outflows peak, schemes become less able to bounce back from set-backs.

Defining 'good' governance is difficult, and pension schemes face certain unique constraints compared to many other organisations. These constraints exist in relation to both decision-making and to the delivery and operational aspects of the scheme.

We believe there is a short cut way of assessing the effectiveness of the delivery model, which involves looking in detail at some of their processes. For most schemes, this review will tell them something that they probably already know - that not all of their processes are efficient or as effective as they could be. However, this will help identify which processes fall into this camp.

In our experience, the effective approach to pension scheme delivery tends to fit one of three models, each with different risks, time commitments and support requirements. We've called these: **'Get Busy', 'Get Simple'** and **'Get Help'**, and we believe that most schemes would benefit from considering which of their responsibilities should fall into which category. Not all processes or schemes will necessarily fit the same approach.

Whether or not a scheme would benefit from this type of analysis clearly depends on the current position, but we believe that for many schemes the need for change is compelling - trustees and sponsors recognise the issues they are facing and change could have a real and long-lasting impact on the scheme.

The first step is self-awareness - about what works, what doesn't, what needs to be developed and what has fallen between the cracks - and a desire to change. In concluding our paper we suggest some self-assessment questions that pension schemes can use to consider where they currently stand, and whether that is a position that they are comfortable with including challenging the behavioural biases that can impact their decision making.

The legacy of today's trustees should not just be the financial state in which they leave the scheme – it should include the governance structure that they leave behind, and a delivery model that is fit for the challenges of both today's – and the future –pension environment; one that assists and propels the scheme towards achieving its long-term goals.

While the paper has a focus and context of private sector DB pension schemes, the concepts are equally of value to public sector pension schemes.

Introduction

UK DB pension schemes continue to face all sorts of challenges. Many of them are financial (bond yields and lack of growth), while some are demographic (increasing life expectancy) and some are regulatory (continued demands of legislation).

But there is more to it than that. When trustees and sponsoring companies are asked what keeps them awake at night and the barriers they face to moving faster, they regularly cite issues that have nothing to do with economics, demographics or legislation. Rather, they worry about things like lack of time, lack of resources, and lack of knowledge and information *(reference: Aon Hewitt's Global Pension Risk Surveys 2012 and 2014).*

In other words, they worry about their collective ability, as individuals with responsibility for a pension scheme, to be able to make all the decisions in the right way, at the right time and implement them effectively.

It is understandable that these are things that worry people, because of all the elements that impact a pension scheme, these are areas that can actually influence. No matter how hard they try, trustees and sponsors cannot influence the financial markets, they cannot make an impact on longevity trends and, despite what politicians and lobbying groups may want us to believe, most have no chance of influencing legislation. So why not focus on what scheme stakeholders can influence – their own ability to react to those things and to acknowledge (and sometimes manage) the risks associated with them.

In practice that means ensuring a few things:

- That the right decisions and actions are taken, and that they happen at the right time
- That the right people make those decisions and take those actions, and that they have the right skills to do so (and that they would not be better done by others)
- That the right information and advice is available to feed into that process
- That all of the above is focused on getting right results in line with the long-term objective, for instance, of achieving Pensions Stability

There is a word for that, and it is felt by large parts of the industry to be one of the most boring in pensions – it is 'governance'.

In this paper:

- We consider how governance generally, and processes specifically, can assist, or distract schemes, in achieving their long-term objectives
- We look at how all parties could create more time to focus on the significant value items and propose that there are three main delivery approaches along a spectrum: 'Get Busy', 'Get Simple' and 'Get Help'. We challenge stakeholders to consider all the options available, with the view that there is not one single approach that fits in all circumstances
- We propose how each pension scheme can start to determine whether this is an issue for them, its importance and possible solutions – with the aim of helping them to achieve their long-term objective of 'Pensions Stability' as quickly and efficiently as possible

Unlike our other papers regarding Pensions Stability: *'Pensions Stability White Paper - turning theory into reality'* and *'Escrow White Paper - reconciling stability and surplus'* this paper does not look at the longer-term objective and financial strategies, but addresses short-term actions that will accelerate the pace of journey towards that long-term goal.

The paper is written with trustees and sponsors of DB pension schemes as its likely audience. We hope that you find this paper interesting and informative.

More information

If you have any questions or would like to explore any of the issues raised in more detail, please contact the Aon Hewitt Pensions Stability team

talktous@aonhewitt.com
+44 (0) 800 279 5588

or your usual Aon Hewitt consultant or one of the authors of this paper (contact details shown to the rear of this paper)

Jackie Daldorph

Paul McGlone

Susan Hoare

Karen McWilliam

James Patten

Governance by any other name

Over recent years there have been plenty of stories in the pensions media along a similar line – that DB schemes face operational challenges. Surveys regularly quote statistics about how little time trustees have, or how they struggle to react quickly enough to opportunities.

Even the largest schemes, which often have the best operational structures and most extensive support, believe that there should be more focus on this area, with a 2013 study, initiated by the Royal Mail Pension Plan, Telent and Saul (*reference: The Russell Pensions Governance Index 2013)*, asking what good governance looks like.

On top all of that, the regulatory environment is demanding better in this area. The Funding Code of Practice for DB schemes is heavily governance based as well as financial. In addition we have the recent requirements for public sector schemes to review their governance requirements as a result of the Public Service Pensions Act 2013 plus the Pensions Regulator's Code of Practice for governance and administration of public service pension schemes, and in addition we have the forthcoming planned European Directive IORP II. These are expanded upon further on the opposite page. From this you can see that governance, whether you call it that or not, is a big item.

If you look at the huge number of items that trustee boards are responsible for on an ongoing basis then it is not surprising that governance is topical. The number of issues and opportunities facing pension schemes has exploded from when trustee and other pension scheme support structures were put in place many years ago. But most governance and delivery models have not evolved to the same extent nor has the time spent on governance matters grown proportionately. The fact that DB schemes are maturing makes these issues increasingly important as pensions, tax free cash sums and transfer values out of the schemes increase. As schemes mature there is less time for asset values to bounce back from any market falls before benefits must be paid - leading to increased risk of large emergency cash calls on the sponsor if the scheme is not appropriately governed.

If we are not careful, regulation will drive the issue rather than schemes themselves. With an EU focus on governance in the impending Pensions Directive, sponsors, trustees and members should expect more attention to be paid to governance arrangements. It would be more helpful, we suggest, if schemes tackled this in their own way and in their own timescales rather than waiting for a Regulator to impose the details and the timescales on them.

"Plans are only good intentions unless they immediately degenerate into hard work"

Peter F Drucker

"Great strategy is pointless if it is not implemented – which is as true for pensions as it is for any other business issue"

The Russell Pensions Governance Index 2013

DB Funding Code of Practice

DB funding (Code of Practice Number 3: Funding Defined Benefits):

- Sets out the objectives of funding valuations
- Defines roles, relationships and decision-making responsibilities of the parties involved
- Outlines knowledge needed by the decision-makers (and supports via training toolkit)
- Outlines the inputs needed across the board e.g. covenant, investment, actuarial information
- Indicates likely process and considerations
- Sets clear timescales and tangible deliverables
- Requires future monitoring and planning for contingencies

Public Sector

Public Service Pensions Act 2013 requires:

- All scheme managers to have Local Pension Boards
- All schemes to have a national Scheme Advisory Board
- Publication of certain information or provision of it to HM Treasury
- A cost cap for employers and national oversight of the setting of employer contribution rates
- Specific responsibilities for the Pensions Regulator

Code of Practice (Number 14). Governance and administration of public service pension schemes, includes requirements relating to the following, many of which have also have legal foundations introduced by the Public Service Pensions Act 2013:

- The knowledge and understanding for members of pension boards
- Conflicts of interest
- Publication of information about pension boards, governance and administration
- Internal controls
- Record-keeping
- The late payment of employer and employee contributions
- Information about member benefits and disclosure of information to members
- Internal dispute resolution
- Reporting breaches of the law

Draft European Directive: IORP II

The draft IORP II is due to be enshrined in member states' regulatory frameworks by 31 December 2016.

The IORP envisages similar structures to those underlying the '3 lines of defence' concept which is much used in enterprise risk management in the insurance, financial and banking industries:

1. Risk control within day to day operational management
2. Oversight functions and policies
3. Independent audit and assurance

What does good governance look like?

Pension schemes are not the only organisations that need good governance, and we can look to examples of governance structures outside of pensions. Corporate governance is often in the headlines, and in particular major financial organisations. But pension schemes are not companies. As Pensions Europe (the European collection of national pensions associations) rightly points out in its statement of May 2014, pension schemes are not just financial organisations, they also have ‘social purpose’. We can therefore also look at the governance of bodies such as school governors and other charities. But it is worth recognising that pension schemes are unique in that they are constrained by pension-specific issues such as their trust structure or fiduciary responsibilities and the nature of their liabilities. We therefore should not be surprised if their governance requires unique approaches as well.

Examining various governance models highlights two things :

- That there is no single structure or set of outcomes that organisations and experts agree on
- That there are a lot of common components that the different models draw upon

Those shared characteristics include elements such as those shown in the diagram opposite. In the Appendix we expand on our governance architecture.

Direction

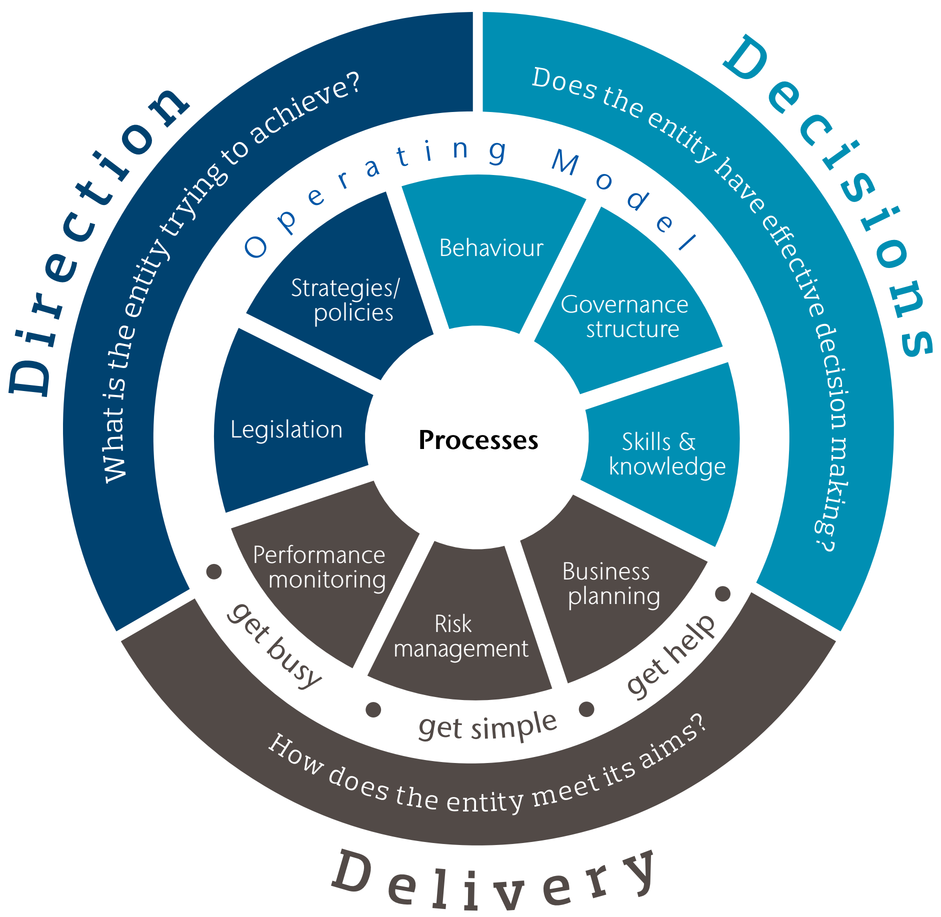
Having clear strategies and policies that also meet legislative requirements

Decisions

Having decisions made by the right people, with the right attitude and the appropriate skills and knowledge

Delivery

Having a clear plan for implementing the strategies and policies, together with appropriate monitoring as to whether they are being achieved, and good risk management to ensure effective and efficient delivery



How to deliver this for a DB pension scheme?

A good governance framework will ensure that you have considered and agreed pension scheme objectives and strategies – but this is rather academic unless we consider whether the processes and procedures in place will deliver those objectives and strategies.

Examining such elements in a vacuum can be time consuming and daunting. We believe, however, that there is a short cut way of assessing the effectiveness of your existing operational structure, which gets to the point quickly – it involves looking in detail at some of your specific processes. Considering how many people they involve, how many handoffs there are, how many external interactions (which are outside of your control) and also whether there are any bottlenecks with too many processes flowing through one person/group.

Processes are the critical underpins to delivering your objectives. Effective processes that work for you - looking from the bottom up - will tell you more about the structures that you need, than reading any number of theories about good governance approaches.

Processes are the nuts and bolts of the pension scheme's workings and, as well as being efficient, they should be contributing to achieving (and at the very least fitting within) your short and long-term objectives. The outcome of each process should enable you to move towards meeting one of your objectives, regardless of how it is carried out.

Any single process in a pension scheme may or may not be efficient. The chart on the opposite page describes a sample process that many pension schemes go through every year, and the conclusions are self-evident.

For much of this report we have focused on situations involving trustees, as the vast majority of pension related issues fall within their remit, but corporate pensions managers also have the challenge of how to prioritise their time (and how to best provide assistance to trustee boards).

A 'good process' ...

Touches all the people it needs to, but no one else

Touches them at the right time, and as few times as possible

Touches people when the right information is available

A sample process

This process starts with a third party, who publishes some information. That information is picked up by the actuary, after which discussion bounces around between the scheme secretary, the trustees and actuary a few times, before the conversation is opened up to include the sponsor and covenant adviser.

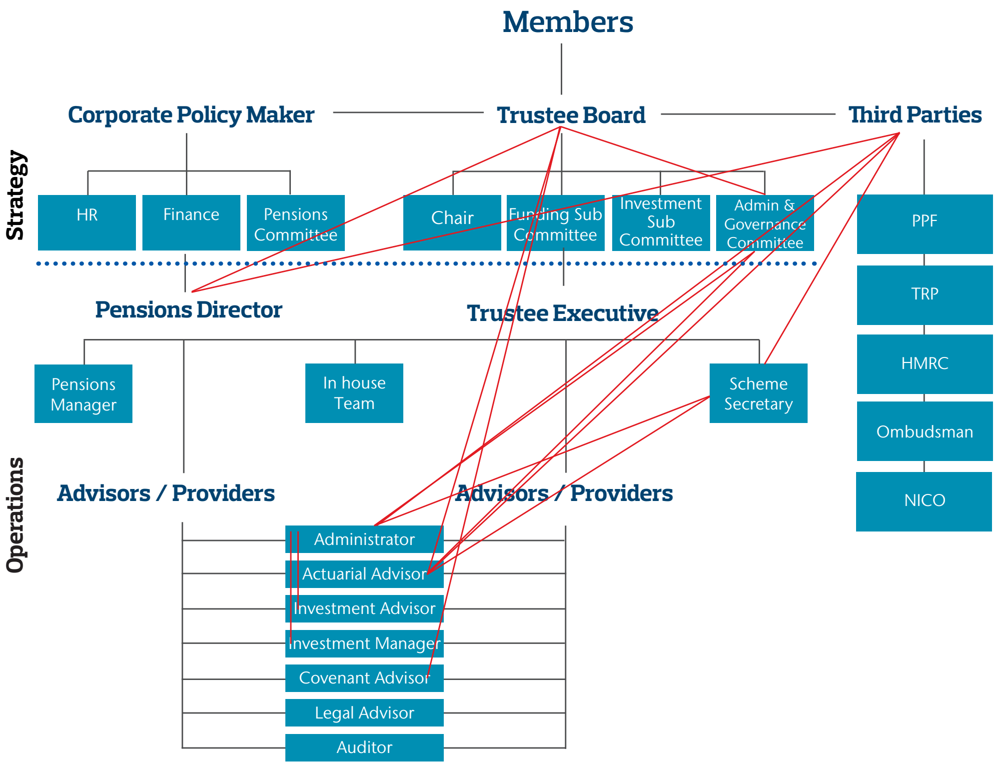
After that back and forth it heads back to a third party, who liaises with the actuary, after which the actuary liaises with the trustees and sponsor. After a while it stops and everyone takes a break.

Then it starts again, this time with the third party sending information to the administrator. The administrator contacts the trustees, then the actuary, and disinvests from the investment manager before liaising with the third party and finally confirming to the trustees that the actions have been taken.

The full process touches eight parties and has 21 handovers, each of which generates cost, time, the possibility of misunderstanding and involves the Trustees and/or Subcommittees and Company eight times. At the very least it has the real potential for distraction from other issues.

The full process involved eight parties with 21 separate handovers

And to think this is just the process that most schemes undertake every year: **to check, and pay, their PPF levy**.



Get busy, get simple or get help

We have, in our experience, effective delivery tends to fit one of three models, which we've called 'Get Busy', 'Get Simple' and 'Get Help':

- **'Get Busy'** is where the stakeholders do just that – they dedicate the time to get busy and get involved in everything from decision-making to day to day operations. They have the knowledge to devote to the task. They have the right people to be involved at all levels
- **'Get Simple'** is where the stakeholders agree to run a deliberately simplified model. It is simple to run, and probably has a lower running cost, but it may not be optimal – either because it misses some opportunities or it leaves financial risk or the possibility for misunderstanding
- **'Get Help'** is where the stakeholders outsource some or part of the delivery for someone else (with the appropriate skills and resources) to run, taking the strategic direction set by the trustees and sponsor through into implementation. It is intended to ensure that the scheme can benefit from all the opportunities available, but without the stakeholders, e.g. trustees, having to 'Get Busy'

To give some examples when thinking about investment decisions this structure is easy to recognise:

- **'Get Busy'** might be a scheme with an investment subcommittee that meets regularly for training and making decisions. They may have a range of managers and asset classes which are actively monitored by the trustees
- **'Get Simple'** might be a scheme with an index-tracking strategy covering only the major asset classes. The whole structure needs much less attention, but it comes with higher volatility and possibly lower returns
- **'Get Help'** might be a full or partial fiduciary investment management arrangement, where the trustees set the strategic direction and the fiduciary manager arranges the underlying asset and manager decisions on their behalf

Outside of investment decisions, the same issues exist whether it is in relation to elements of administration, member communications, funding, employer covenant and even the management of governance (such as trustee training or secretarial services).

In practice no trustee board or corporate pensions team will put all of its processes into the same category – there will be a mix whereby certain things have the time devoted to then, some are simplified, and others are delegated. Getting the right overall delivery model is about getting the right mix of these approaches.

Some processes will benefit from the ability to progress quickly – and all but the most 'busy' of schemes may be best suited to the 'Get Help' approach. For example, by monitoring the buyout market to be able to transact at a pre-agreed trigger, where the speed of transaction can have a tangible impact on the terms obtained.

Similarly, few trustee boards have the resources and structure to be able to respond as quickly as a fiduciary partner to take advantage of transient opportunities – where moving quickly can have significant financial impact.

We believe there are some common features between processes most suited for a 'Get Busy', 'Get Simple' or 'Get Help' approach:

Stakeholders need to consider questions such as:

Do trustees have sufficient time available to 'Get Busy' in all areas?

Are they willing to accept the compromises of 'Get Simple' in some areas?

Or, do they want to free up some time for key decisions by selecting certain areas to 'Get Help'?

	Get Busy	Get Simple	Get Help
Examples	Setting overall strategy Monitoring employer covenant Determining death benefit recipient	Member communications Member options at retirement PPF levies	Group life insurance placement Transacting annuity purchase at a pre-determined price Calculating early retirement factors
Tasks that are particularly suitable are those where			
Financial impact is	Medium to high	Low	Low to high
Level of expertise required is	Medium	Low	Low to high
Amount of resource required is	Low	Medium	High
Process is	Simple	Simple	More complex
Completion is	Not time critical	Time critical	Time critical
Discretion is	Required	Not required	Not required
Benefits from aggregation are	Unimportant	Unimportant	Potentially significant
What would the experience be like under the different approaches			
Costs	Unchanged	Reduced	Reduced
Type of supporting advice	Full	More directive	Delegated implementation
Time needed from all stakeholders	Significant	Reduced	Reduced

Type of advice required

How the trustees' work is impacted, and how they request that their advisers provide advice and recommendations is likely to be different under the different approaches. We are all familiar with the 'full advice' approach where a number of options are presented with backing information and the trustees discuss and decide. But in a 'Get Simple' situation the trustee board may just want a single directive recommendation and rationale (plus any appropriate compliance papers as an attachment), rather than a list of options and the pros and cons of each. Where items have been delegated to advisers in 'Get Help', the big decisions will have been taken by the trustees and the adviser is merely following the direction and implementing – followed by reporting and any audit trail documentation.

Across the spectrum of delivery models (but particularly for 'Get Simple' and 'Get Help') the speed and efficacy of decision-making may benefit from having a single financing adviser who combines both asset and liability advice (eliminating the need and cost of having both the actuary and investment consultant always 'in the room').

Revisiting whether to bundle providers (for instance appointing one firm for administration, secretarial and financial consulting) may suit some models – making them speedier and with less governance required by the trustees.

Fees vs cost

We often hear that outsourcing and delegating work to other parties must surely add explicit cost? While this may or may not be the case, there needs to be a comparison of apples and apples in the context of the overall value that it derives – getting towards the objectives faster, with less cost or less risk. For instance:

- Delegating the transaction of bulk annuities when a pre-agreed trigger has been hit will have an explicit fee cost but a very small swing in the market during any time delay otherwise occurring would likely far exceed this
- Delegating investment strategy implementation: consider how much saving could be made by switching from an underperforming investment manager more quickly
- Delegating, preparing and issuing some member communications to a third party might appear to incur higher fees than currently, but if the 'cost of trustees' time that would otherwise have been spent on this were to be valued, it is unlikely that a large difference would be seen
- Delegating setting early retirement factors could have a lower cost. While the adviser takes on more decision-making power - this is somewhat offset by not needing to undertake the work of preparing comprehensive options and training for trustees

In some situations, the explicit costs themselves can be lower– **'Get Help'** solutions can involve pooling resources with those of similar schemes for a more efficient solution. For example, in the case of fiduciary investment management, assets are typically pooled with those of other schemes, often leading to economies of scale compared to running the same structure independently under a **'Get Busy'** approach

Access to the right information

The three different ways of running the processes outlined in the previous section need different surrounding support. For instance, if we look at management information:

Provision of management information		
1. Get Busy	**2. Get Simple**	**3. Get Help**
• Financials, legislation, markets etc information available when required (e.g. via the web) • Funding trackers monitoring both historic movements and future 'what if' projections • Opportunities Register to show progress. Track possible actions and schedule for future review	• Much of this information is no longer required • Electronic board packs and storage may suit the streamlined nature of this approach	• Dashboards showing the provider's delivery of actions and measuring outcomes will be key tools

We need to reconsider the information given to decision-makers and whether this fits their needs and aligns with their chosen method of organisation. We think many would agree that the information available, and reporting mechanisms, lead behaviours and thereby drive the results.

Differences also exist in other areas. For example, why would trustees who have decided to 'Get Help' in an area want or need detailed technical training about that topic? Could they replace a small part of this time with broader skills development around decision-making and discussion of how to monitor the actions delegated to others?

Is it worth the effort to re-engineer?

So is it worth making changes to delivery models in the way outlined, and how do you go about doing it?

We believe that it is definitely worth it, for a number of reasons:

1. It is something that many schemes are worried about. They recognise that it's an issue, so why would they not take action to deal with it?
2. It has a real impact on the ability to run the scheme smoothly, capture opportunities and avoid risks
3. Some schemes have a substantial number of years left to run, so any new delivery model will have a long time to repay the investment
4. If you keep doing things the same way, it is likely that you will get the same results – whereas the objectives of most schemes is to move forward and get to financial and operational stability

Even if you agree with all of the above in theory, does it apply already? We believe that most pension schemes can do more to improve outcomes, and have set out, on the opposite page, the behavioural biases for you to consider. In addition, please turn to page 16 and consider our self assessment statement to see how you fare.

Based on your responses it should be fairly clear where there are changes that you could make. If you are not sure, or if you would like to benchmark yourself against other schemes, please fill in the answers on the website, at **aon.com/governancesurvey**

"Securing annuity prices when prices are 5% cheaper ....means that the scheme has some three times the likelihood of getting to Pensions Stability in the next 10 years"

Reference:

Pensions Stability White Paper '*Turning theory into reality 2014*'

"The definition of insanity is doing the same thing over and over and expecting different results"

Quote often attributed to Albert Einstein

Before deciding whether you should be doing things differently, we would set you the challenge of considering the behavioural biases that may have impacted on your group decision-making:

- **Anchoring** – where it is hard to made a big change from the current position, even if you would do so if starting with a blank piece of paper
- **Status quo** – more weight is placed on previous decisions rather than re-evaluating and considering decisions afresh. Fear of making a change that might subsequently be viewed negatively leads to inertia and potentially retaining an existing sub-optimal state
- **Confirmation bias** – a course of action is decided on and then evidence is sought to confirm this course
- **Group think** – desire for harmony or conformity in the group leads to poor decisions. This can also extend more widely to advisers and other schemes - recommending/taking the same course of action as other schemes is viewed as being less likely to attract criticism, leading to herding across the industry and increasing risks of concentration and contagion

These can be reduced by:

- Separating the strategy from the implementation to avoid second thoughts (or anchoring) at the point of implementation
- Incorporating decision-making bias checklists into the decision-making process to tease out any unintentional biases
- Encourage a 'devil's advocate' type lens to be used to review decisions made, to increase robustness and avoid confirmation bias and group think

Please indicate whether you agree with the statements below	Strongly Disagree	Disagree	Slightly Disagree	Slightly Agree	Agree	Strongly Agree
1. Decisions sometimes take months, from the point that they are initially raised to the point that a final decision is made and implementation commences	○	○	○	○	○	○
2. We often discuss the same issue at a number of meetings, either because a decision was not reached the first time or new information is to be considered	○	○	○	○	○	○
3. There are so many things that need to be on a meeting agenda, that it is often difficult to find enough time at short notice to appropriately consider new opportunities without reducing time on (or deferring) other essential items	○	○	○	○	○	○
4. There are frequently items on agendas that do not need any decision to be taken	○	○	○	○	○	○
5. Projects that we would like to undertake sometimes get deferred because there is not sufficient resource (people and/or money) to deal with them	○	○	○	○	○	○
6. When ideas are rejected, we have a robust process for reconsidering those issues in the future	○	○	○	○	○	○
7. We have a one year business plan for the pension scheme that has SMART* objectives, is more than just a calendar of tasks and meetings and has a strategic focus	○	○	○	○	○	○
8. If the buyout market became 10% cheaper two days ago and represented a strong opportunity for our scheme then we would know about it by now	○	○	○	○	○	○
9. We have an operational plan that sits alongside our funding plan, and describes how the governance structure of the scheme will change and remain aligned over time	○	○	○	○	○	○
10. The people making decisions and taking actions are always those who are most likely to get the best outcome, have sufficient time available to act quickly (when appropriate) and are the most cost efficient	○	○	○	○	○	○
11. Decisions and actions sometimes touch more people than is really necessary (including trustees, employer and advisers), including people who don't contribute much to the decision	○	○	○	○	○	○
12. Individuals often focus their time on the agenda items that they find most interesting and not necessarily because they are key priorities	○	○	○	○	○	○

* SMART - Specific, Measurable, Achievable, Realistic, Time-bound

How did you score?

If you ticked *Strongly Agree* or *Agree* on questions 1 to 5 or 11 or 12 or *Strongly Disagree* or *Disagree* on questions 6 to 10, then you may have identified that you would benefit from change.

What might you achieve once you have reorganised?

Again and again we have identified that time is the biggest barrier, so here is an example of how the results of working smarter could massively improve the focus and quality of the scarce time available when strategic stakeholders (e.g. trustee boards) are collected together.

The chart on the left probably resonates with many trustee boards. This is what many trustee meetings look like currently, ignoring travel time, a major amount of the time is spent reviewing things that have happened, reviewing information already provided and carrying out training. This leaves little time (if any) to look at major items and strategic value additions.

The chart on the right shows a position which we believe is achievable, by following some of the ideas in this paper, and would give significant additional time to dedicate to decisions which have the potential to add major value. The additional time available should drive results in getting you further towards your long-term objective, and Pensions Stability.

Good governance is:

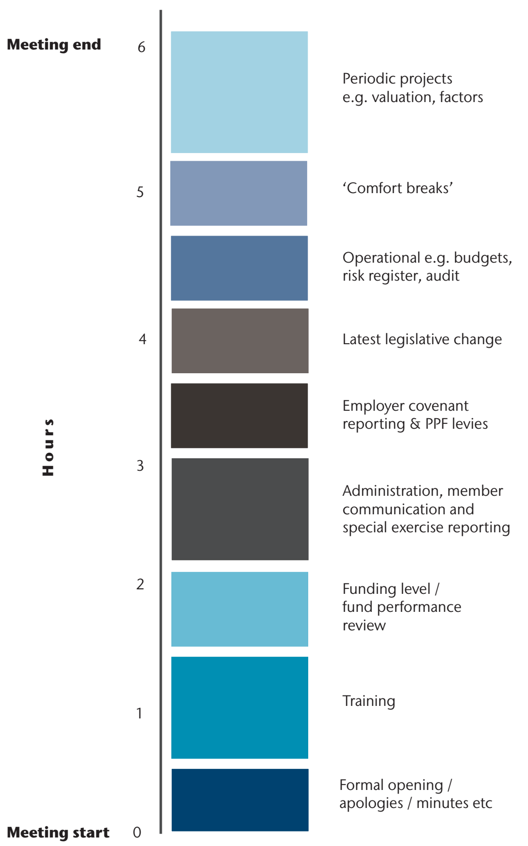
That the right decisions and actions are taken, and that they happen at the right time

That the right people make those decisions and take those actions, and that they have the right skills to do so (and that they would not be better done by others)

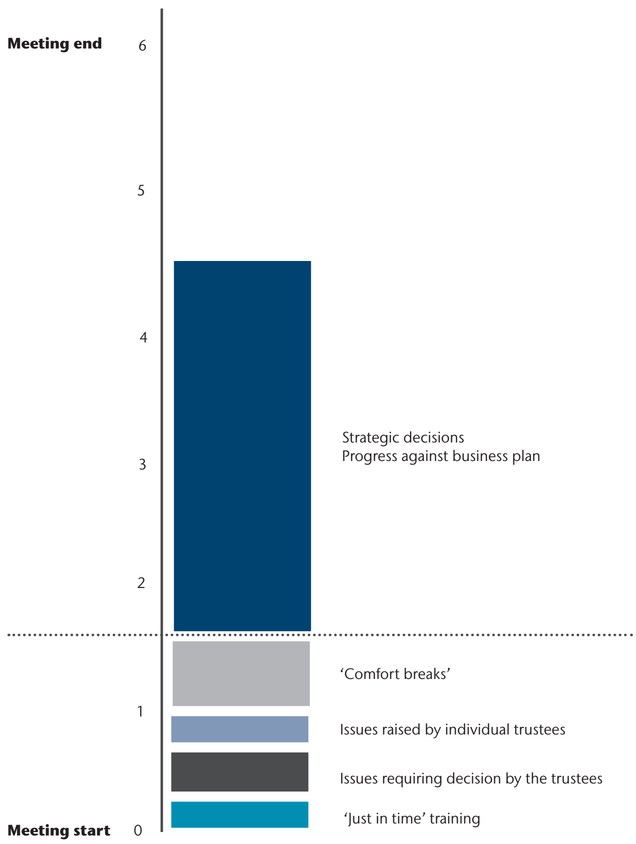
That the right information and advice is available to feed into that process

That all of the above is focused on getting right results in line with the long-term objective, for instance, of achieving Pensions Stability

Before improvement



After improvement



Fixing the issue

How do you go about fixing any issues that you identify?

We give some initial thoughts below, and the authors of this paper would be delighted to discuss these further with you. There will be no one 'correct' approach, but there are two ways of tackling this – either or both of which can be used: 'Top-down' or 'Bottom-up'.

Top-down: Direction, Decisions, Delivery

Identify your objectives in the key areas, such as those identified below, with the trustees and sponsor working together:

- Consider the risks of not achieving these objectives
- Review what reporting and monitoring metrics are appropriate
- Identify the key barriers and likely derailers of success
- Consider and utilise the current and possible enablers, things that will help you achieve your aims
- Capture your ensuing actions into your annual Business Plan, and establish a progress reporting dashboard

This will give you the overall context and support within which your delivery model is to work. It leads on to defining that model and determining how to run individual processes in detail.

Bottom-up: Delivery, Decisions, Direction

Identify a small number of example processes which you think are a distraction, are currently sub-optimal, you do not like doing or which you do not have the necessary skills to do. For instance, think about items which you have discussed at recent meetings, work that you have recently done – does this give a first subset of processes to consider? Get input from the other stakeholders, advisers etc. This does not need to be a long list.

- Note how these work currently, perhaps using the organisational structure shown on page 9
- Review and agree the shortcomings of the current approach
- Describe a better process – perhaps with ideas from whether this best fits a 'Get Busy', 'Get Simple' or 'Get Help' delivery model (see page 10)
- Then think of similar processes....

How you deliver items that influence your broader governance elements e.g. the skills and knowledge needed, risk management approaches, performance monitoring etc.

Whatever you do – do not try to do it all at once, as we know you do not have the time! We suggest exploring one 'Top-down' category and/or 10 'Bottom-up' processes. This is likely to give a shape of delivery and approaches that can be extrapolated across swathes of other processes and areas.

Above all, under both approaches, push against the decision-making biases that we outlined on page 15.

Having a facilitator to challenge and push for exploration, is likely to bring both well needed additional resource and result in a better outcome.

Call to arms

Governance and the issues identified in this paper are areas where the vast majority of the UK pensions industry could improve, and thereby improve outcomes and accelerate them towards their longer term objectives. While we do not believe that there is one answer that is appropriate for all, we do believe that we will all benefit from sharing views, wisdom and experiences. If you would like to participate in the debate please contact one of the authors.

If you keep doing things the same way, it is likely that you will get the same results ...

There is less time for schemes to bounce back

Example case studies

'Get busy'
Action the plan

January 2012

Scheme A requested a full review of derisking options – including liability management, partial buyin etc. The trustee team of actuary, investment adviser, lawyer, investment sub committee and full trustee board carried out the review with the UK company team. The issues were then referred to the group parent. Before a response was received, markets changed.

January 2013

Again, Scheme A requested an update of the derisking options etc, markets changed (again).

Early 2014

The trustees 'Got Busy' on individual components and:

- Established a more formalised and actioned derisking of the investment strategy
- Implemented liability management exercises and undertook a benefit audit in respect of two specific sections of the scheme
- Moved to electronic meeting packs and document storage to ease access and ensure a better flow of information. Also established an Opportunities Register to record, monitor and schedule future actions
- Transitioned to web-based funding updates/projections with access for trustees and company

In order to do this the board:

- Added resource: increasing the hours available by key trustees and support
- Delegated more decision-making to sub-committees
- Delegated projects and implementation to administrators/ investment consultant
- Worked directly with the company on individual projects
- Moved to review by dashboard and exception approach rather than hands-on understanding of details

Result

Inflation and interest rate hedge increased, saving the scheme from exposure to unforeseen recent interest rate falls

Better articulated and agreed flightplan in place

Liability management exercises concluded with good take up, and scheduled review in three years' time

Rectified benefit audit issues in two categories. Scheme is now better placed to take advantage of any future derisking options

CETVs reviewed and implemented of post April 2015, reducing exposure to member selection

Improved relationship with sponsor due to common access

'Get simple'
Radical approach to meetings

Scheme B found that trustee meetings were eating into the time of company representatives, which could be better spent on core business activities. Two years ago, they decided to 'Get Simple':

- They set direction/strategy in conjunction with the company
- Day-to-day running decisions are made by email and conference calls scheduled when they are required. This is organised by the professional Chair of Trustees and Secretariat, who keep on top of issues and decisions
- No face to face meetings have happened for the past year
- Now moving to web-based document library and decision-making

Result

Scheme has performed all the tasks it was likely to have done anyway

Time saved for majority of trustees, who are effective within the sponsor business

Time heavy on the professional Chair of Trustees and Secretariat

'Get simple'
Simplifying investment governance

Scheme C found that they had nine different managers/mandates. As a £150 million scheme they considered that to run this to achieve the returns promised was too governance heavy. This was especially so as they always seemed to have one manager which they should have reviewed and moved away from, and a new idea they should be considering.

They extended valuation discussions to undertake an investment strategy review, but with one clear criteria being to reduce governance without reducing expected return.

Result

Reduced mandates with four managers

Restructured asset allocation without impacting the expected return, but also reduced risk significantly

Agreed a pragmatic approach with sponsoring company to implementing new structure

‘Get help’
Setting actuarial factors (non CETV) with directive advice

July 2011

Scheme D undertook a review of whether factors remain appropriate for commutation, early retirement, late retirement etc – all recommendations were accepted.

July 2013

Scheme D has full factor review with a large advice document produced for Trustee meeting, which massively over-ran the 15 minute slot allocated. All recommendations were accepted.

2014

Formal valuation

Start 2015

Trustees told the actuary that as he knew their funding plans, he was sufficiently informed to be able to determine what factors they should use.

The actuary prepared one sheet for the non-contentious factors (e.g. early retirement) with his directive recommendation, and one sheet for discussion on contentious factors (e.g. commutation).

Result

The 2015 discussion took 15 minutes and focused on the important issues – 50% of cost

Trustees are now considering whether in future to delegate setting some factors to the actuary

‘Get help’
Achieving buy in

Scheme E Trustees’ adopted Aon Hewitt’s fiduciary management service, including the Implemented Annuities service.

Combined with continuing generous financial support from the sponsoring Company, this quickly achieved the returns required to get to buyout cost. It also contained risk exposure more tightly than traditional asset management approaches, and then provided prompt closure of growth asset exposure to stabilise the funding position.

Once the Trustees and sponsoring Company had decided to proceed to buyout, Aon Hewitt scheduled all actions needed and ran a competitive broking process. The annuity contract was signed a week after all decision-makers had agreed the transaction.

Result

Achieved annuity purchase

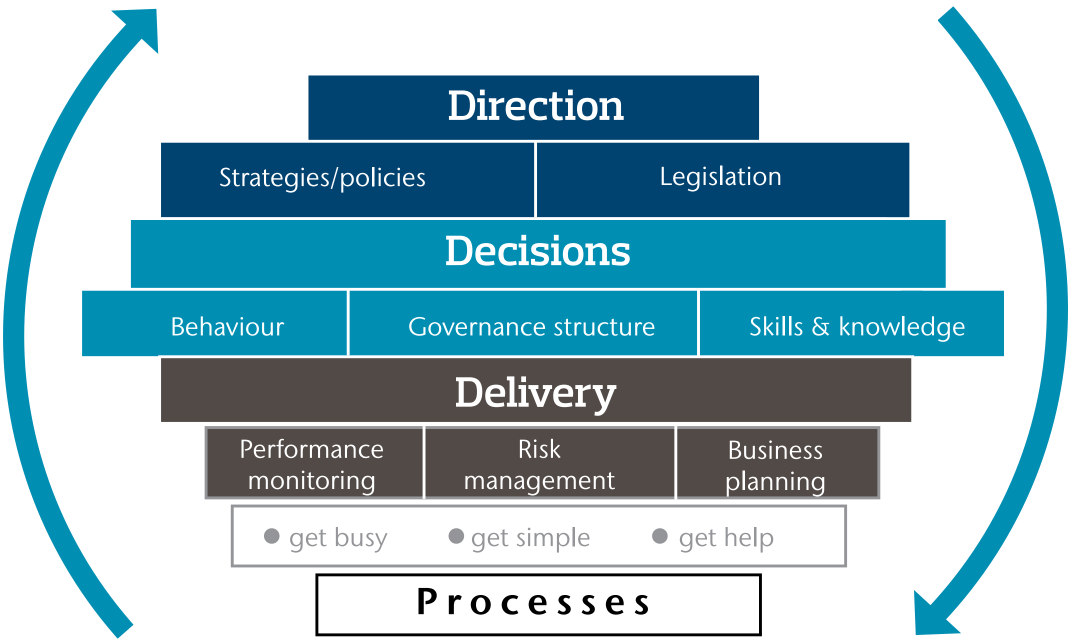
Appendix

Articulating our structure

We propose:

- The **Direction** a scheme wishes to take should be reflected in the Decisions made: ideally agreed between the trustees and the sponsor company
- The **Decisions** made should be implemented through effective Delivery
- Underlying the **Delivery** of the strategic and day to day items are the processes

To achieve objectives most effectively, a connected upwards and downwards flow is desirable. The following shows the architecture we use to test that these connections are made, record a scheme's current position, changes, benchmark against its peer group and to ensure the scheme has covered all the areas needed for compliance with current legislation, best practice and draft IORP II.



Contacts

Jackie Daldorph
Senior Partner
+44 (0) 1727 888 225
jackie.daldorph@aonhewitt.com

Paul McGlone
Partner
+44 (0) 1727 888 613
paul.mcglone@aonhewitt.com

James Patten
Principal Consultant
+44 (0) 113 291 5076
james.patten@aonhewitt.com

Susan Hoare
Principal Consultant
+44 (0) 117 900 4441
susan.hoare@aonhewitt.com

Karen McWilliam
Principal Consultant
+44 (0) 117 929 4001
karen.mcwilliam@aonhewitt.com

About Aon

Aon plc (NYSE:AON) is the leading global provider of risk management, insurance and reinsurance brokerage, and human resources solutions and outsourcing services. Through its more than 69,000 colleagues worldwide, Aon unites to empower results for clients in over 120 countries via innovative and effective risk and people solutions. For further information on our capabilities and to learn how we empower results for clients, please visit: http://aon.mediaroom.com

© Aon plc 2015. All rights reserved.

The information contained herein and the statements expressed are of a general nature and are not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information and use sources we consider reliable, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Aon Hewitt Limited is authorised and regulated by the Financial Conduct Authority, Registered in England & Wales.

Registered No: 4396810.

Registered office:

The Aon Centre

The Leadenhall Building

122 Leadenhall Street

London EC3V 4AN

aon.com

Risk. Reinsurance. Human Resources.

Empower Results®