Marris Miller

Pension Trustees: How to Support Them, and Your Organization

The Pension Papers™

Even though they are responsible for the future trajectory of pensions, pension trustees regularly cite issues such as a lack of time, resources, knowledge and information gettig in the way of their achievements. As a result of these inadequacies, whether they consist of structural or personal barriers success, pension stakeholders may suffer if there is a lack of alignment between pension trustees and pension strategies.

One of the biggest challenges to pensions, is that boards are closed social networks, in which decisions are made behind closed doors and there are very few checks and balances in place. In this way, boards can easily become echo chambers marked by low-stakes decision-making rather than strategic aims. The onus is on organizations to choose good pension trustees. Instead of simply choosing the closest or most familiar individuals for the task, it's important for pension trustees to be strategically and methodologically chosen.

This paper delves into key issues when it comes to building an outstanding Board of Trustees for your pension goals, such as finding and appointing suitabe people from both the member-nomiated and company-nominated opinions. Find out how to develop a clear agenda, terms of reference, critical delegations, good advice papers and a robust audit trail. Learn how to facilitate assessments to highlight shortcomings eve where trustee confidence is high.

M. Catherine Miller
Managing Partner, Marris + Miller

The information in this publication should not be relied upon as consulting advice. We encourage you to contact us directly with any specific questions.

CONTENTS

Pension Trustees: How to Support Them, and Your Organization 4

Building An Outstanding Board Of Trustees 5

What Makes A Good Pensions Trustees? 7

Developing A Clear Agenda 8

Facilitating Trustee Assessments 9

Let's Do It Right The First Time 11

Pensions Trustees: How to Support Them, and Your Organization

When asked what makes it difficult for them to plan for the future of their businesses, pension trustees regularly cite issues such as lack of time, resources, knowledge and information. [1] The more that our global economic system becomes complex, that level of stress only increases.

It's all too common for pension trustees to worry that they're not doing their jobs.

But the challenging thing is that that may actually be true. Pension trustees may be directly failing at building and protecting pensions, and we may not even know it.

Research from this year conducted in the UK shows that most Boards of Trustees rate their own effectiveness highly, and perhaps much more highly than they should given the fact that they rarely actually internally review that effectiveness with accurate metrics. In fact, as the International Centre for Pension Management at the University of Toronto's Rotman School of Business claims, there isn't even evidence to show that *independent* reviews of boards of trustees are effective. In other words, boards worry about their collective ability to make informed and timely decisions about their pension responsibilities and implement them effectively, but don't often dig deep enough to figure out what's going wrong.

But what about trustees' work in the first place? Do we actually need to be *that* concerned?

Apparently we do. Even if pension trustees receive training and, through their role, accumulate experience in financial markets, field research shows that they may decisions, by and large, for non-financial reasons. [2] Who they know, what their biases are, and what they've read in the news that week may factor more significantly into pension trustees' decisions than the serving of the actual pension and its strategic intent.

[1] Apostolakis, G, Krannen, F., & van Dijk, G. (2016). Pension beneficiaries' and fund managers' perceptions of responsible investment a focus group study. *Corportate Governance: The International Journal Of Business In Society, 16* (1), 1-20.
[2] Weiss-Cohen, L., Ayton, P., Clacher, I., & Thoma, V. (2019) Behavioral biases in pension fund trustees' decision making. *Review of Behavioral Finance*, TBA..

So, what's going on?

What happens when good governance relies on people who aren't fully prepared and supported?

This paper will delve into key issues when it comes to building an outstanding Board of Trustees for your pension goals, such as finding and appointing suitable people from both the member-nominated and company-nominated options. We'll also talk about how to develop a clear agenda, terms of reference, critical delegations, good advice papers and a robust audit trail. Finally, we'll examine how to facilitate assessments to highlight shortcomings even where trustee confidence is high.

Building An Outstanding Board Of Trustees

Before we explore best practices, we have to understand what's already going wrong when it comes to Boards of Trustees.

The biggest challenge to pensions is that boards are closed social networks in which decisions are made that are absent from public opinion or interest, and there are very few checks and balances in place.[3] In other words, boards can easily become echo chambers marked by low-stakes decision-making rather than strategic aims.

Despite the fact that there are increasing regulations to challenge these closed networks, the pool of trustees continues to be very small, with senior executives sometimes sitting on many different boards at the same time. What this means is that the decisions made by one company can begin to echo those made by others, even in the same field. This acts to further deepen social ties and embed poor practices across firms. Of course, the core challenge is, then, that boards are not created in the best interest of a company or its stakeholders.

Recent research in the field has shown that opening up the social network and adding diversity to boards in the form of women and minority members can increase financial success for a company, over both the short and the long term, and yet 40 per cent of public

[3] Chambers, N., Harvey, G., Mannion, Rl, Bond, J., & Marshall, J. (2013). Theories about boards. *Health Services and Delivery Research*, 1(6), 1-19.

companies do not include women on their boards, whether corporate, pension or non-profit. Including women and people of color results in better attendance to government regulations and financial accounting structures as well, leading to fewer ethical compliance issues, and yet this is simply not happening.[4]

In a recent study in Canada, for example, it was found that many business leaders make the wrong assumption that women are not as committed to business development as men are, or do not have the skills for board management, and therefore were not offered board positions as often.[5] The reverse has been proven to be true, in that corporate and pension boards are likely to financially benefit from the appointment of women directors: boards with women equal better decisions and an increase in financial success. Even so, the contribution of women directors on boards can often depend on their ability to make alliances with influential board members, which may or may not be possible because of closed social networks. In other words, the reason for women's exclusion from boards is not based on their efficacy or their ability to engage investors, but rather on false assumptions about their worth and ability to contribute. Not prioritizing women's participation, as well as the participation of a range of diverse individuals, ultimately, can limit a board's potential to serve their stakeholders.

What does all of this mean?

The onus is on organizations to choose *good pension trustees*. Instead of simply choosing the closest or most familiar individuals for the task, it's important for pension trustees to be *strategically and methodologically* chosen.

Given this high bar, how can you find pension trustees that meet these criteria?

A Canadian study on recruiting pension trustees found that the most effective method to achieve that goal is to literally use a human resource management approach in which the position is listed, candidates are interviewed based on their experience and skills, and are vetted by third parties.[6] The job description should be thorough and explicit. Nominations

[4] Isidro, H., & Sobrla, M. (2015). The effects of women on corporate boards on firm value, financial performance, and ethical and social compliance. *Journal of Business Ethics 132*(1), 1-19.

[5] Greenwood, J. (2011). Well-run films have women on board: Downe. *Financial Post*, October 17.

[6] Sayce, S., Weststar, J., & Verna, A (2014). The recruitment and selection of penion trustee: an integrative approach. *Human Resources Management Journal, 24* (3), 307-322.

should be eschewed. Candidates should be able to apply from within the company and without, but using an independent human resource or pension management consulting firm could help to ensure that the process is fair and unbiased. Once candidates with the appropriate competencies have been found, they ought to be onboarded, trained, and engaged in the same way as others in the firm.

What Makes A Good Pensions Trustee?

An extended study that was initiated by the Working Group of the Trustee Leadership Forum for Retirement Security, a project of the Initiative for Responsible Investment at the Kennedy School at Harvard University, stated that there are seven key traits that make a trustee good at their job.

These are the traits for which you should be recruiting in your pension trustee search:

1. **The strength not to be intimidated.** Pension trustees have to have fundamental sense of strength and self-awareness so that they can make decisions on their own. This is the core skill, the Kennedy School suggests, that underlines the rest of the skills to follow.
2. **The willingness to be perpetually inquisitive.** Pension trustees have to actually be interested in their pension work. They aren't simply following the tide, but have the wherewithal to discover what's new and different in the pension industry and be critical of what they find, so that they can provide the best advice for their team.
3. **The strength to be unwaveringly ethical.** This seems to go without saying, but pension trustees should be chosen from among those who are the most trustworthy and have experience keeping to an ethical framework. An up-and-coming executive or a go-getter may not have the right state of mind to protect the assets of a whole workforce, and take all stakeholder needs into account.
4. **The ability and willingness to articulate clear and unbiased thinking.** This is a tough one. In the Weiss-Cohen et al. study cited above, both individuals who are nominated by the members of the pension fund and those who are put forward by the company are often much more likely to make decisions based on what others recommend, rather than doing their own research. Decisions are too fast and too biased to make the right impact, and are mired by confirmation bias. Pension trustees ought to be independent thinkers who won't vote via groupthink.

5. **The strength and willingness to be diligent.** Even without doing external research of their own, pension trustees have to be willing to read the materials that are put in front of them. If they don't have the inclination or, more frequently a problem, the time, then pension management is not for them.
6. **The ability to not be blinded by the deliberate distractors that are perpetually put before trustees.** There are a lot of factions in pension decisions, the Kennedy School suggests, that lobby pension trustees to follow their lead. This shouldn't matter to the decision making process at all.
7. **Highly effective trustees are great listeners and great interlocutors.** They look for ways to bring people together without advancing a single opinion, but instead build on stakeholder ideas and knowledge to create a great plan.

Developing A Clear Agenda

The agenda that is set by pension trustees, one that has its own set of values and responsibilities, has to reflect that of the firm's overarching business strategy. These matters are typically detailed in the organization's bylaws. The bylaws commonly also specify the number of members of the board, how they are to be chosen and when they are to meet, but more planning is always necessary. This process is about alignment: a pension plan has to reflect this strategy so that everyone is working towards the same outcomes.

Canadian research shows that the average agenda of pension trustees needs to evolve in a significant way.[7] Outside of the pension itself, there are several agenda practices that have to be put into place for trustees to work effectively.

- **Development of a board self-improvement culture.** The board of trustees has to want to work towards best practices, so that they can develop and maintain general standards aimed at improving the governance practices of pension funds. The culture of the board needs to reflect the needs of the organization as a whole, and should also reflect the same criteria for pension trustee good governance traits noted above.
- **Create a defined strategy.** A board's activities are determined by the powers, duties, and responsibilities delegated to it or conferred on it by an authority outside itself. Nonetheless, pension trustees ought to draft a scheme business plan of their own, which includes the scheme's objectives, long-terms goals, and how they propose to meet them.

[7] Johnson, K. L., & de Graaf, F. J. (2009). Modernizing pension fund legal standards for the twenty-first century. *Rotman International Journal of Pension Management*, *2*(1).

- **Provide and work with a deep understanding of the board's mission and its investment beliefs.** This is where alignment comes in. Business needs and pension needs go hand in hand, and structures that better align interests of service providers with those of fund participants and beneficiaries will serve all stakeholders more completely. Every year, this mission statement should be revisited and affirmed, or changed to reflect new focus areas.
- **Create a code of ethics.** The trustees need to have their own ethical code that begins with regulatory norms but goes beyond them. This can be achieved by placing the impetus on best practices in governance in ethical terms. Without an underlying standard for ethics, which is kept in check by a strong board, company or collective agreement leaders may aim for more than they can handle.
- **Put processes in place to ensure lower trustee decision risks.** Evidence of excessive investment herding behaviour for all participants and beneficiaries is frequent in Canadian pension plans, and a risk management strategy that creates checks and balances for trustee actions can help to alleviate this.
- **Create clarity in all responsibilities.** Make sure that pension trustee agenda items are based on their job descriptions and nothing else: overstepping the bounds of these responsibilities can lead to ongoing issues. Consideration should be given to a 'comply or explain' reporting approach on compliance with best practices to provide flexibility.
- **Create clarity in record keeping.** Pension trustees should have specific frameworks for decision-making, governance structures and processes and document them clearly at every meeting.
- **Mandate regular external trustee audits.** This is not a financial audit, but an external test of possible conflicts of interest and compliance to the business strategy. All trustees ought to be subject to dismissal and/or prosecution if they break the letter or the underlying values of this code of ethics.

Facilitating Trustee Assessments

As we've discussed above, boards are a closed social network in which decisions are made that are absent from public opinion or interest, and therefore there is a significant need for their work to be overseen, despite their independence. Even with diversity processes in place, pension boards of trustees can still become echo chambers in which the thoughts and desires of those in power are

are replicated. What this means is that, when this takes place, there is a limited ability of the board to execute its key role: critical assessment of pension activities.

Decisions also need to be subject to ample criticism in order for a company to move forward on new pension initiatives, and the diversity of opinion that is likely to occur in a more informed and professional board will serve this purpose. Even so, a company is working in its stakeholders' best interests if it can regularly fully engage in a board review process so that they can protect their interests, ideas, and values, as well as their bottom lines, over the long term through positive board tactics.[8]

As noted above, pension trustees should already have their pension strategy and business plan and associated key metrics in place that can be assessed on an ongoing basis, just as they would any other business plan. But facilitating trustee assessments must go deeper than financial checks and balances, according to findings from the pension management research literature.

There are three ways that assessments can take place.

Review. Start with interviewing trustees on a regular basis or using an individual board member performance review process similar to other human resource processes, in order to open up communication and address internal or external issues as soon as they come up. This is not a call for micromanagement, but rather a means to build effective working relationships between the board and the pension management team. Understanding and addressing challenges at the individual trustee level will drive improvement in overall board effectiveness.

Reflect. Create a reflection based culture and ask for regular feedback on specific pension challenges and proposals through trustee surveys at board meetings. These can be quick processes meant to get a snapshot of what trustees are thinking about ideas for the future, predictive risk issues, or other potential changes in the pension environment that will have an effect on the business and its pension stakeholders.

[8] JChambers, N., Harvey, G., Mannion, R., Bond, J., & Marshall, J. (2013). Theories about boards. *Health Services and Delivery Research*, 1(6), 1-19.

Report. Not adequately specifying pension performance evaluation methods right from the beginning could lead to not capturing important pension performance data which could impact the timely discovery of problems. It could also mislead the pension management team about other project goals that were not specifically detailed. Key performance metrics have to be defined and checked, and there needs to an iterative process in place for updating and improving outcomes based on those metrics.

But let's also be clear: employing performance metrics for pension planning shouldn't only be based on meeting financial goals, but also on 360-degree or multiple-constituency feedback that takes place as often as it is needed.

As we've mentioned, critical challenges in pension trustee work have been tied to groupthink and political power plays, and this leads to less effective outcomes for pensions no matter how tight the purse strings. Leaning into a feedback-based culture will not only allow multiple stakeholders to feel as if they are being heard, and therefore feel more empowered to make positive changes, but it will also allow the organization to assess their pension trustee needs with competency models. This means that it is possible, and even likely, that your organization will choose to remove pension trustees from their positions when they don't prove to be effective.

Let's Do It Right The First Time

Having the right structure, the right processes and the right people involved in running a pension scheme makes sense, but we have to proceed with a business orientation in mind. It's critical to provide trustees with the right skills to not only mitigate the risks the pension plan faces over the long term, but also to capitalize on any short term market opportunities.

How can pension trustees step back from the processes, procedures, tools and issues that surround their board daily and consider: 'Could we be working more effectively?' or 'How could we do things better?'

It all starts with a pension trustee culture that is professional, purposeful, and practical. It's not enough to create a board with people who know your business: they also have to want to know the pension business, and they have to be people who can be trusted with decisions upon which families and business leaders alike can depend.

You can align pension trustees with your business and the organization's purpose and goals. It's not just what you want for your pensions, but what you want for your businesses, organizations, customers, employees that matters. You can tap into insights into how your way of managing pensions – from communication to risk management strategies – can help you to achieve your desired organizational outcomes and impact.

Let's demand business sense from our pension trustees, and ask for a long term performance orientation that moves everyone forward.

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