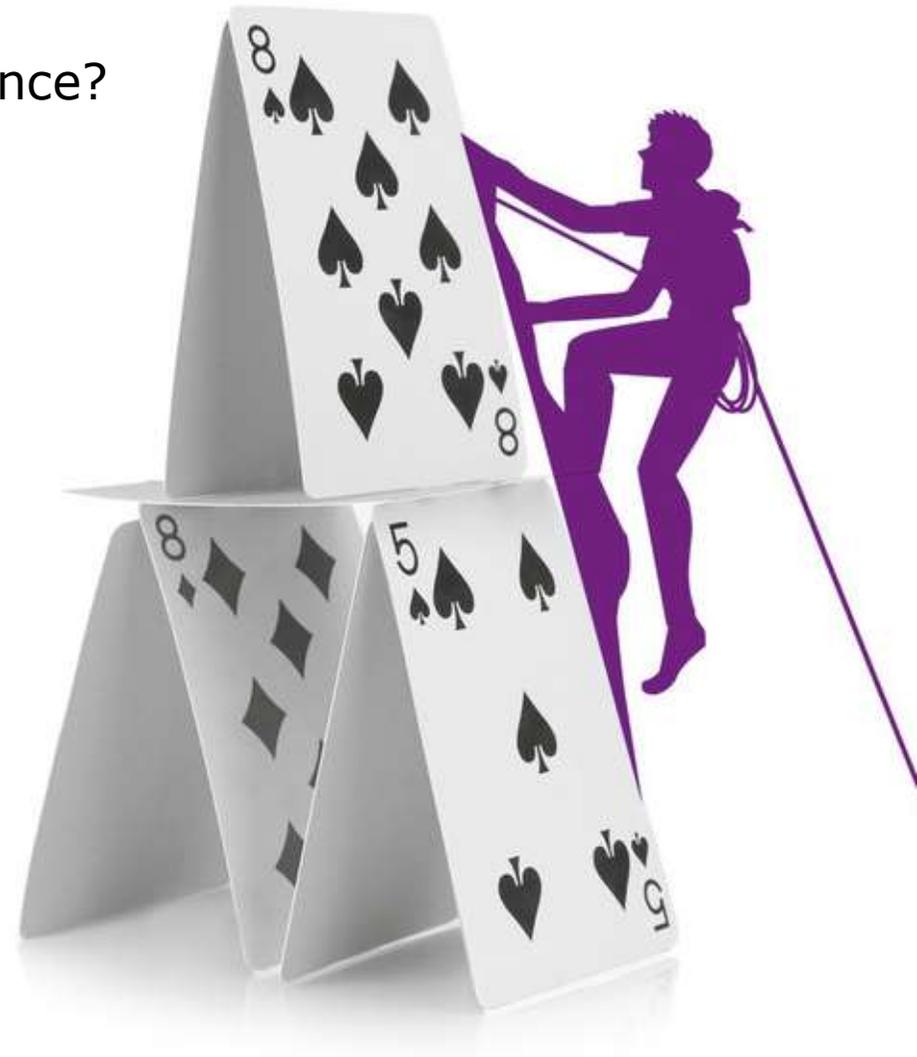EVERSHEDS SUTHERLAND

White Paper Conference

Own Risk Assessments – what actions should trustees take to ensure compliance?
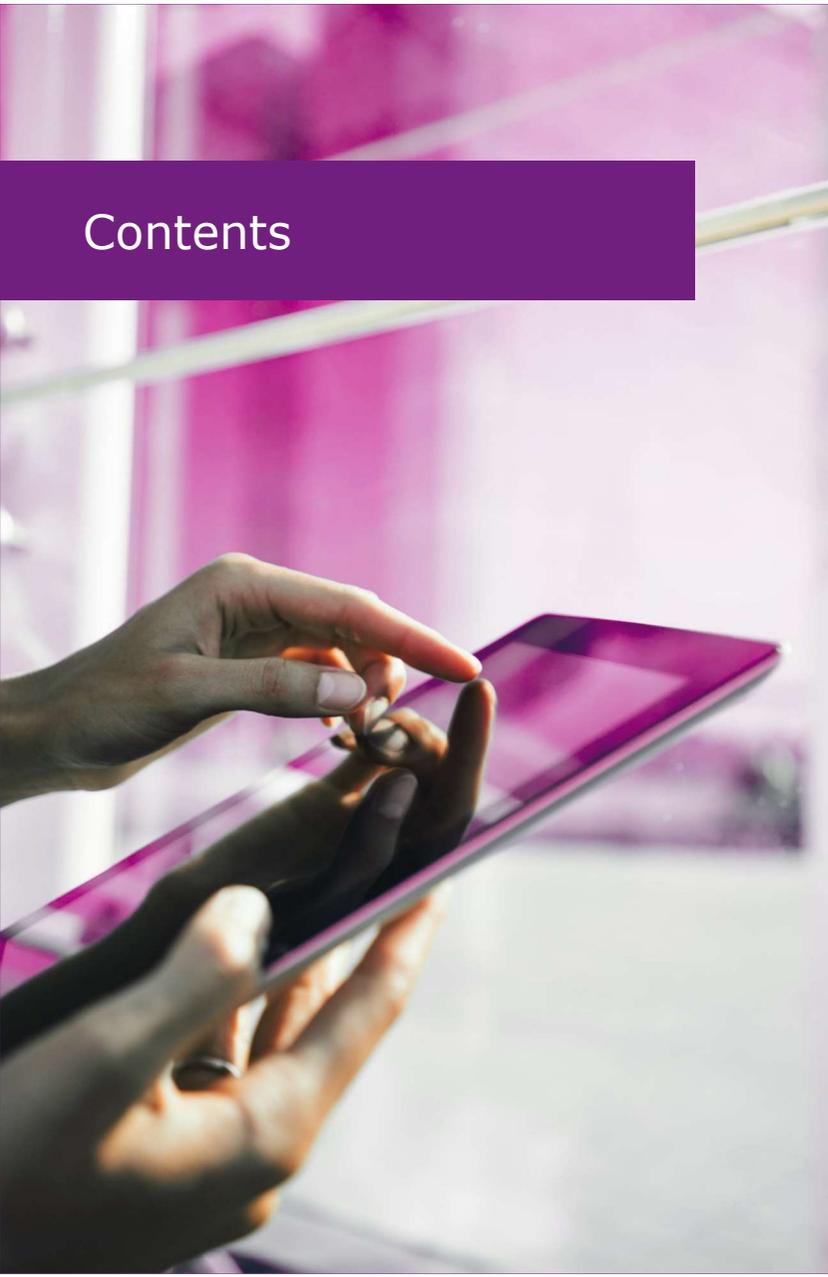
What can and should trustees do?

22 September 2021

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Partner

Contents

Own Risk Assessment
Key dates

IORP II (transposed into Pensions Act 2004 and 2018 Governance Amendment Regulations)

24 August 2021, TPR published its interim consultation response on draft Single Code

Summer 2022 likely earliest date it will take effect

17 March 2021-26 May 2021, draft of Single Code issued for Consultation

Spring 2022 – earliest date (according to TPR) that a final version of final code is expected to be laid before Parliament

How did we get here?
Key drivers for change

— Supplementary pensions increasingly important in Europe because of changing demographics

— European Commission wanted to provide a common level of security for members across Europe

— Regulator concerned about standards of governance in some schemes

— Increasing alignment of occupational pension governance requirements with financial services sector

— Regulator wants to appear tougher

What does the law require?
Key provisions from IORP II

— Pre-dates Brexit

— Effective system of own governance

— Proportionate own-risk assessment:
  - at least every 3 years
  - prescribed content

— Needed to be implemented into UK law by January 2019

— European origins explain odd terminology

— This presentation focuses on the ORA but important to understand how it sits alongside the ESOG

Article 21: Member States shall require all IORPs to have in place an effective system of governance which provides for sound and prudent management of their activities. That system shall include an adequate and transparent organisational structure with a clear allocation and appropriate segregation of responsibilities…

Article 28: Member States shall require all IORPs, in a manner that is proportionate to their size and internal organisation, as well as to the size, nature, scale and complexity of their activities, to carry out and document their own-risk assessment.

What does the law require?
Amended provisions in s 249A Pensions Act 2004

— Previously a requirement to establish and operate internal controls.

— Since January 2019:
  — trustees must establish and operate an effective system of own governance including internal controls
  — which is proportionate to size, nature, scale and complexity of scheme

— Exceptions for:
  — authorised master trusts and CDC schemes
  — public sector schemes (although is a separate requirement to have internal controls)
  — schemes with fewer than 100 members

— Penalties

What does the law require?

The Occupational Pension Schemes (Governance) (Amendment) Regulations 2018

Regulator must issue a code of practice which, amongst other things, sets out how trustees should carry out and document an ORA

This should include how the trustees address:

Decisions	integrate the ORA into decision making and management
Risk management	assess effectiveness of risk management system
Conflicts	prevent conflicts if outsourcing key functions to employer or its employees
Funding	assess scheme's funding needs
ESG	assess new and emerging ESG risks
Risks to members	assess risk to members and effectiveness of remedial action
Operational risk	assess operational risk
Protections	assess protections including guarantees and covenant

New "Super Code"
Requirement to introduce ORAs

— Draft of Super Code issued for consultation on 17 March 2021. Consultation closed 26 May 2021

— Designed to consolidate and update existing 15 Codes of Practice (current draft consolidates 10 of them – more to come)

— Not just consolidation

— What's not in there:
  — funding provisions will be added in later
  — further consultation due on master trusts
  — notifiable events
  — subsisting rights
  — material detriment

— Implements governance requirements stemming from IORP II (transposed into Pensions Act 2004 and 2018 Governance Amendment Regulations):
  — requirement to operate and maintain an effective system of governance including internal controls ("ESOG")
 — conduct an Own Risk Assessment ("ORA") of the ESOG

What does the Pensions Regulator require?
Draft single Code of Practice

The draft Code and consultation paper says the ORA:

— Requires assessment of the effectiveness of, and risks posed to, the effective system of governance

— For governing bodies to demonstrate full consideration of their risk management processes – external, financial and operational

— Should not be perceived as an item of tick-box compliance, or an unnecessary burden

— Does not need to be published or sent to Regulator

— Private sector schemes with 100 or more members

— Arguably the most significant development in the Code

— Will be a substantial process
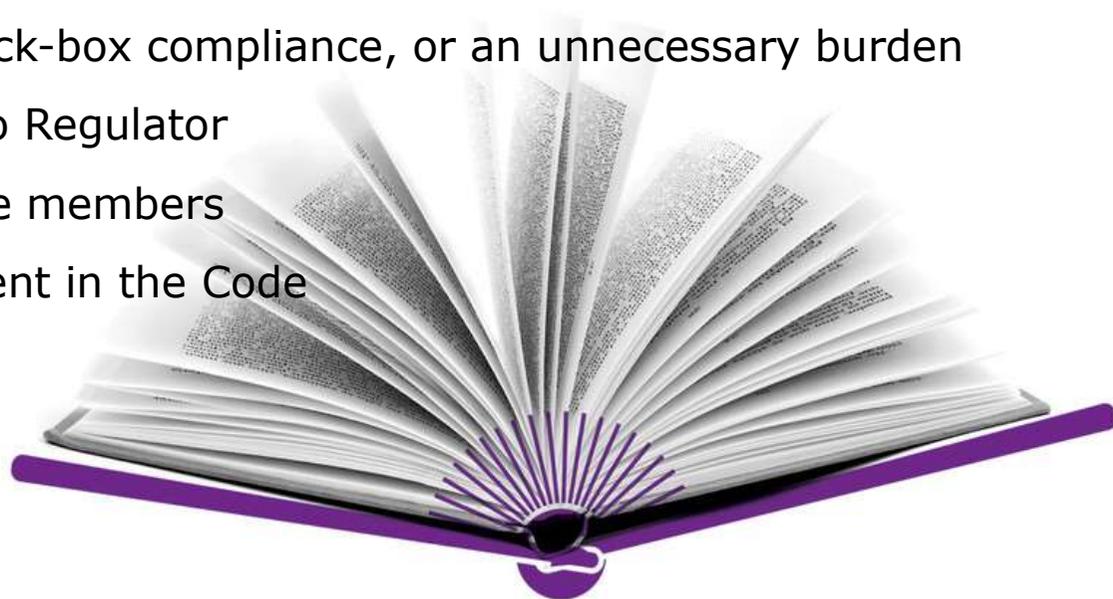
Own Risk Assessments
Key points

— Many schemes will already have broadly comparable review processes in place already, while others will have to expand their processes considerably

— TPR:

"The ORA we propose builds on the principles set out for the effective system of governance.

The ORA is then a regular process that requires the governing body to assess the effectiveness and risks of the effective system of governance.

This is distinct from the normal risk management processes for the scheme. The ORA is therefore a process for assessing the management of risks".

— TPR: *"the circumstances of each scheme will affect the risks it faces. It is therefore possible for governing bodies to tailor their ORA according to the size, scale and complexity of their scheme"*

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Documenting the ORA

— Ensure the ORA is in writing and signed off by the chair

— Provide ORA documentation to all members of the governing body

— Ensure the documentation is available on request

— The governing body should record:
  — the date on which the ORA has been prepared
  — the date on which the next ORA will be prepared
  — details of any interim reviews or updates that the governing body has carried out or plans to carry out

— The ORA documentation should cover:
  — how the governing body has assessed the effectiveness of each policy and procedure
  — whether they are effective and why

Own Risk Assessment
What will an ORA need to cover?

As with ESOGs, TPR has created a module that acts as an index for the elements it expects the ORA to consider. It summary it should cover:
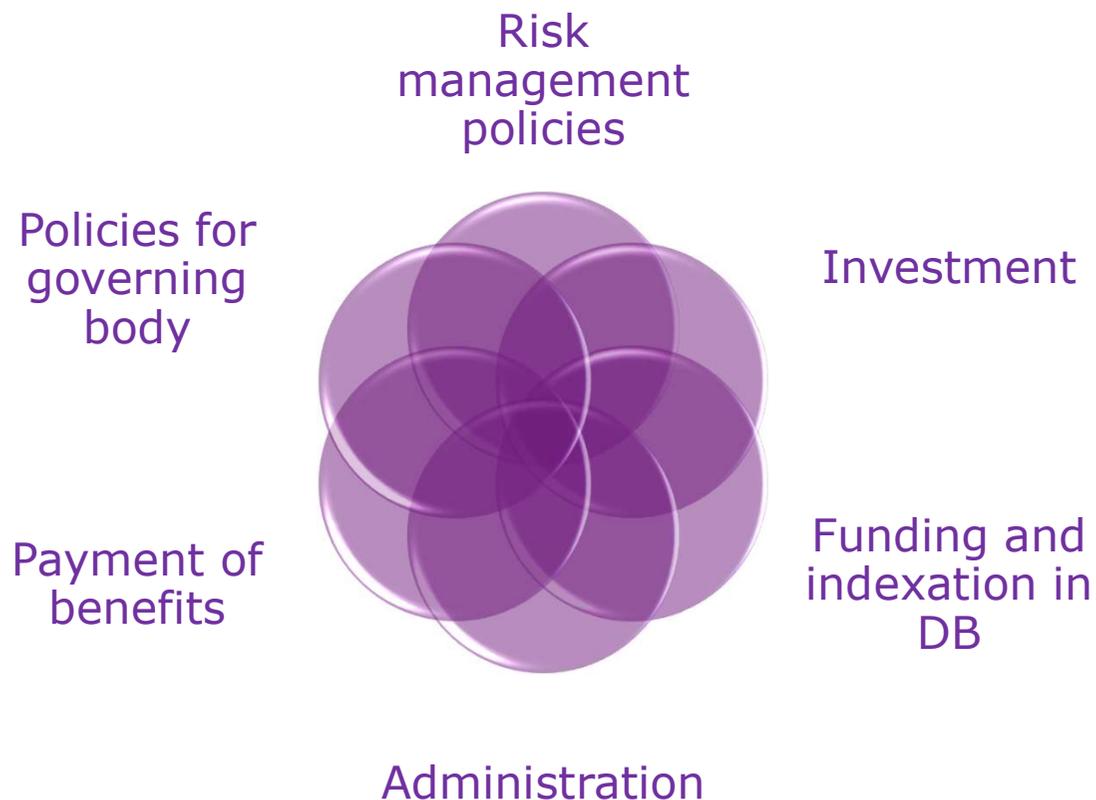
— effectiveness and operation of policies to identify and assess risks facing the scheme and of the scheme's internal control policies and procedures

— management of potential internal conflicts of interest

— continuity planning for the scheme and, where applicable, how it has performed

— effectiveness of investment processes, including how the scheme assesses investment risks related to climate change, social risks and regulatory change

— how the scheme assesses funding and sponsor insolvency risk

— how the scheme addresses operational and administration risks

What does the Pensions Regulator require?
Draft single code of practice

The ORA must consider the effectiveness of, and risks arising from, each element below:

Risk management policies

Policies for governing body

Investment

Payment of benefits

Funding and indexation in DB

Administration

Timing
When should schemes have complied with ORA requirements?

- Legislation:
  - first ORA "*within 12 months [of] the last day of the first scheme year that begins after the Regulator has issued a code of practice*"
  - reviews not more than every three years

- Draft Code of Practice:
  - first ORA within one year of code coming into force
  - reviews within 12 months of last or where material change in risks

- Interim response to consultation:
  - legislative timescales a maximum **BUT** will reconsider how often ORA should be reviewed
  - Code unlikely to be effective before summer 2022 **SO**
  - first ORA needs to be completed summer 2023 or later
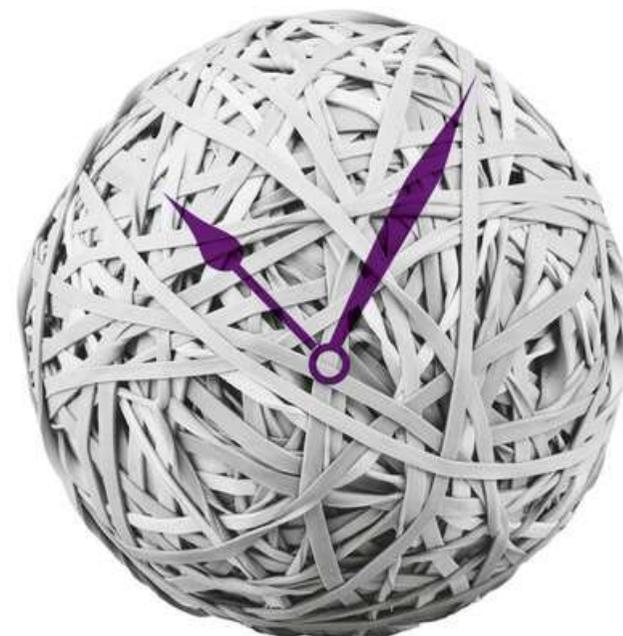
Numerous responses to TPR Consultation
TPR:

- TPR reviewed 103 responses from a broad range of stakeholders including private and public service schemes and those providing services to schemes. The breakdown of respondents was

Public service scheme	24
Representative body	17
Private sector scheme	16
Legal firm	15
Consultant	12
Trustee company	7
Insurance company	6
Administrator	3
Other	3

Own Risk Assessments

How have the proposals been received ? – Industry feedback

Most commented on module in Draft Code. Generated much coverage.

Professional Pensions Article "Half of trustee boards do not review themselves"

— "Only half of trustee boards currently review their own effectiveness on an annual basis… according to Willis Towers Watson"

— "just 3 in 10 boards appoint some form of external reviewer to conduct the assessment, as could be mandated in the future"

— "WTW's recent governance survey found that a quarter of schemes either only carried out a review on an ad-hoc basis less than once every 3 years or never"

Own Risk Assessments

How have the proposals been received – more industry feedback

— "Sponsors reviewed their schemes trustee boards even less frequently with a whopping 81% stating that it was ad-hoc, less than once every 3 years, or never."

— "…a majority of trustee boards said they did review their objectives, integrated risk management approach, and governance arrangements annually, at 75%, 72% and 56% respectively"

— "The vast majority of schemes did not identify weaknesses in the governance of their pension fund throughout the pandemic… with just 22% stating that there were minor or major weaknesses for engagement of trustees in scheme meetings…"

— "…findings were largely positive, with trustees also embracing technology for monitoring and tracking as well as for decision-making"

— "Survey found that 73% believed that the role of trustee has significantly more risk attached to it now than ever before"

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PLSA Response to TPR's Consultation

- Points of confusion include:
  - what the document should look like and how it should be structured
  - whether it should include references to the risk register and how much overlap there is in content
  - how far the ORA can build on and use existing materials that schemes already hold on this topic

- An ORA template would be useful

- There will be a cost to compliance without a template

- Without guidance there is a risk that lots of schemes will adopt different approaches

- Concerns about the risk of unintended consequences and whether the ORA would result in a new audit requirement

- An annual requirement is too onerous

Responses to TPR's consultation
Other concerns

— Too great an emphasis on the need to have written processes and procedures for all aspects of scheme operation

— Might not lead to a reduction in risk as focus on procedure rather than on the potential risk itself

— Not clear what a proportionate approach means in the context of an ORA

— A blurring of the distinction between legal requirement and best practice

— Using resources to produce ORA might not improve member outcomes

— Lighter touch approach might be preferable

Pensions Regulator's interim response to consultation

— On 24 August 2021, TPR published its interim consultation response on the draft Single Code (https://www.thepensionsregulator.gov.uk/en/document-library/consultations/new-code-of-practice/interim-response-to-consultation-on-tprs-new-code%20)

— TPR received 103 responses from pensions industry and other interested parties

— It has decided that a longer period of review is required before publishing its consultation response and the final code for Parliamentary approval

— No firm date for publication of final code, but TPR states it is not expected to be laid before Parliament before Spring 2022. So unlikely to take effect before Summer 2022

— TPR noted that this longer period of review may allow it to incorporate code content arising from the PSA 2021 in the first iteration of the new code

— TPR noted that there was general support for its approach

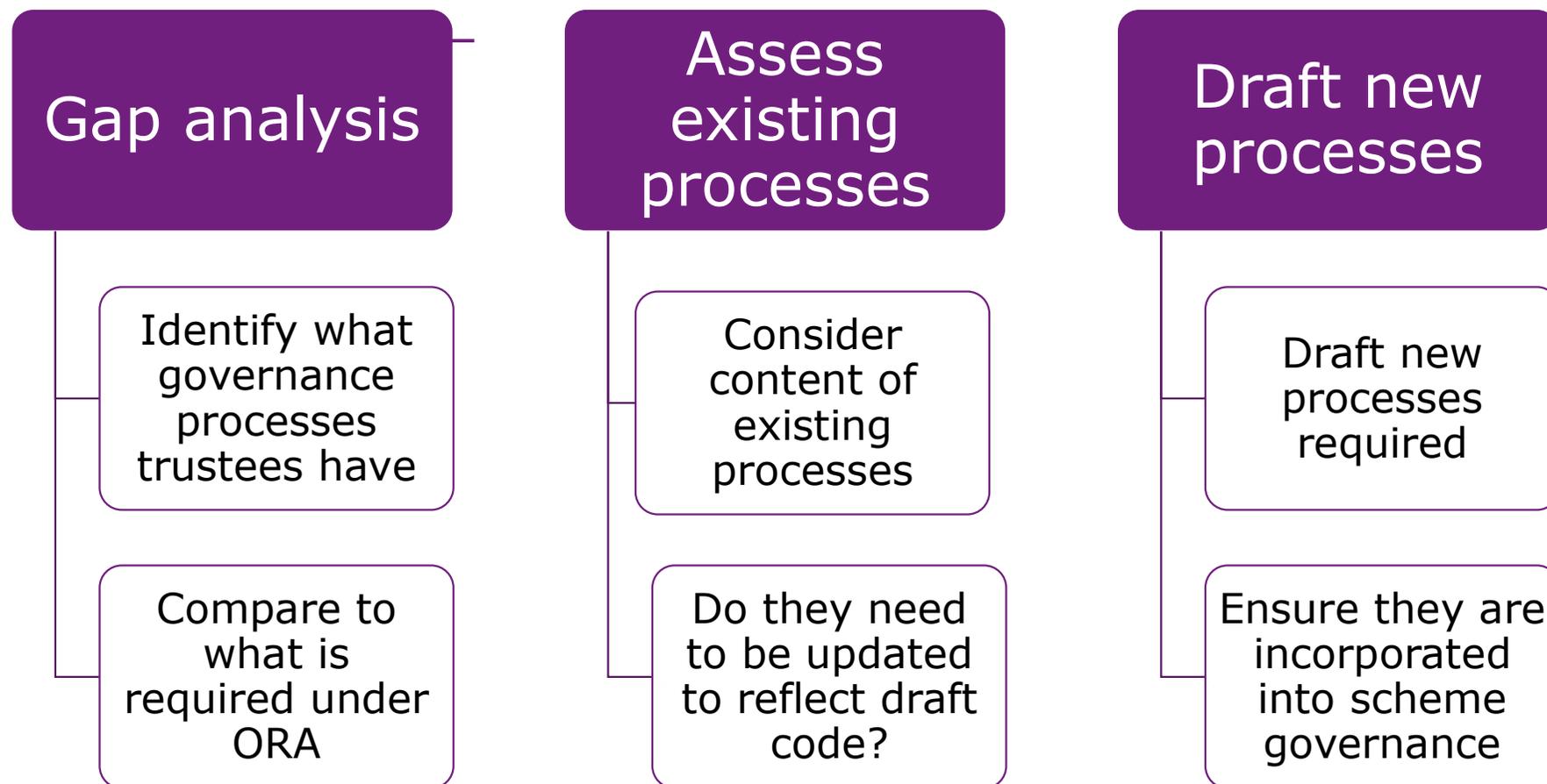# TPR's interim response
What did TPR have to say?

ORA

— "Perhaps unsurprisingly, the greatest attention focused on one of the new legislative requirements reflected in the new code, the own risk assessment"

— Most respondents appear to have correctly understood the purpose of the ORA as a review of a scheme's existing risk controls. Few, if any, respondents objected to the principle of this new process. However, some did raise concerns about the amount of work it would entail, the timeframe, what the finished product would look like and the burden it would place on smaller schemes

— Following feedback, we remain of the view that trustees should prepare their first ORA in a timely fashion, i.e. taking the legislative timescales as a maximum but preparing the document in a shorter timescale as a matter of best practice. We will also consider how often governing bodies should review the ORA

— We continue to work through the responses in this area to identify other possible changes or guidance requirements, particularly for smaller schemes

Next steps

— We are carrying out a full review of the comments received on each of the modules and will consider each carefully. In considering our next steps, and preparing the final version of modules, we may contact stakeholders to examine whether our proposals address the issues they identified. We would particularly like to thank those organisations who have already volunteered to assist in this way

— We do not currently have a firm final publication date for the new code. However, we do not expect to lay the new code in Parliament before spring 2022. It is, therefore, unlikely to become effective before summer 2022"

Gap analysis

- Identify what governance processes trustees have
- Compare to what is required under ORA

Assess existing processes

- Consider content of existing processes
- Do they need to be updated to reflect draft code?

Draft new processes

- Draft new processes required
- Ensure they are incorporated into scheme governance

Own Risk Assessments
- What should trustees do next? Practical considerations and steps

— Plan ahead - Trustees and administrators have full agenda but don't put this off. Put time in calendar now to plan for implementation of ORAs

— Time - Take advantage of delay in introduction of Code - TPR noted in its Interim Response to Consultation that "unlikely" Code will come into force before Summer 2022. Use extra time to prepare for ORA implementation

— Mindset - adopt a positive mindset – incentive to really "kick the tyres"

— Engagement - engage with and embrace the task!

— How To - Use the Super Code and any TPR guidance

— Spread the load - Set up a working sub-committee comprising heads of each sub-committee

— Or engage trustee board as a whole and split tasks out – many hands make light work

Own Risk Assessments
What should trustees do next? Practical considerations and steps

— Role of advisers - consider who will take lead: trustees or advisers?

— Engage advisers to point out requirements and how they see other schemes going about the task

— Rome wasn't built etc… - iterative process over two years for production of first ORA

— Template vacuum - take advantage of the template vacuum and TPR's lack of prescription – trustees "*need to use their own judgement as to what is reasonable and proportionate*" – you have freedom to choose

— Template a double edged sword:
  — while there isn't one, trustees have freedom to structure as they see fit – encourages breadth of thought and assessment – result a more engaged and self informed trustee and a better ORA?
  — if there is one trustees have the comfort that someone else has done part of the thinking for them and their boundaries are set
  — My view – no template is better, but we shall see..

Own Risk Assessments
Practical considerations and steps

— Next Summer - planning and prelim work carried out now will ensure schemes are better prepared for any changes in Summer 2022

— Future reviews - assess how ORA framework and regular review process can be automated/streamlined in the future
  — agenda item at each main trustee board meeting
  — iterative/incremental updating at regular intervals throughout the year easier than one off job at the end of each year

— Penalties - be mindful of penalties for non-compliance with ORA requirements. Likely to be interventions for non-compliance – how will that "look"

— Future developments: a growth area – automation and role of Artificial Intelligence? AI – encouragement not to think?

Key takeaways
ORAs need not be ORAble (horrible)

— It is what it is - implementation and formalisation of ORAs reflects continuing evolution of TPR and the pension scheme trustee

— It's the World we live in - reflects the introduction and growth in compliance and risk assessment that is increasingly "*de rigeur*" in all sectors and walks of life

— Sunlit uplands - better governance results in better outcomes for schemes, sponsors and members which surely is what we all want to see

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Conclusions…
What does it all mean?

— Better, more robust governance

— Not a nightmare - adopt positive mindset – an opportunity/incentive to really examine your ESOG and learn more about your scheme

— Not an MOT - "*It is a progressive activity documenting milestones of continued governance improvement, rather than a certificate determining adequacy at a single point in time*" – Dalriada Trustees

— Not limited - Template vacuum is good – minds won't be limited

— Step up to the plate - Advisers need to help with pragmatic guidance and comfort

— A lot of work – more than trustees might think – needs to be approached positively to benefit fully

— Thereafter – iterative updates

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