HYMANS # ROBERTSON

The coming of age of sole trusteeship

A guide for employers on sole trusteeship and market providers

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Executive Summary

With sole trusteeship on the rise and larger schemes increasingly adopting a sole trustee governance approach, the market is starting to come of age.

As sole trustees increasingly start to sharpen their approach to servicing schemes in this way, in part due to the introduction of a new voluntary code, we explore the impact on sponsors, trustees and the broader pensions market.

The number of DB schemes over the last five years has continued to fall steadily from around 6000 schemes to c.5300 and a significant majority of these schemes have assets of around £20m.

We estimate schemes governed by professional corporate sole trustees ("sole trustees") are around 10% of the overall DB universe today but professional trustees are strongly of the view that this is set to change rapidly in the next few years.

Our recent survey into the growth of sole trusteeship pointed to the expectation of significant growth in this area with a doubling of mid-size[1] schemes governed by sole trustees in 5 years' time.

This could mean that schemes governed by sole trustees are perhaps 20% or more of the overall DB universe in 5 years' time.

We hope you find our report insightful and interesting. We'd be happy to discuss any aspects with you so please do get in touch with any of the authors below.

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[1]Our survey captured data on growth of schemes with assets of more than £20m

What is a professional corporate sole trustee?

The Pensions Regulator described a "sole trustee" in its 2019 consultation on the Future of Trusteeship and Governance as

"an individual who solely performs the trustee role for the scheme, including sole trustee directors or other individuals acting on behalf of a corporate trustee – for example, on behalf of a professional trustee firm".

At Hymans Robertson, we advise a number of schemes operating with sole trustees and have done for a number of years. Like many respondents to The Pension Regulator's (TPR) 2019 consultation, we believe that sole trusteeship can provide benefit to some schemes but it is important for employers to appropriately test the suitability of the governance model for their scheme and have regard to the new voluntary code in running the appointment process.

From an advisory perspective, working with sole trustees is in some ways similar to working with a trustee board, however there are notable differences too. As sole trustees do not necessarily need to convene a meeting to discuss and conduct scheme management, day-to-day scheme governance can be managed continuously and projects can be progressed without working to board meeting dates. This leads to more informal and regular engagement with advisors and can avoid the need for lengthy briefing papers to facilitate decisions. This more nimble way of working means that strong audit trails of decisions and advice taken is even more important.

Whilst there is currently no specific regulation surrounding sole trustees, the Professional Trustee Standards Working Group, which included representation from The Pensions Regulator, issued guidance in 2019 as part of the Professional Standards and accreditation regime. Subsequently the Association of Professional Pension Trustees (APPT) issued a Code of Practice effective 1 January 2021 setting out principles for trustees acting in the role. Most notably, the guidance sets out that sole traders should not accept appointments as sole trustees and neither should firms that are not adequately resourced to mitigate the additional risks and responsibilities. The Code of Practice also formalised the term PCST, reflecting that going forwards the role is increasingly expected to be carried out by accredited professional trustees in line with the Code of Practice. In this publication, we focus on PCSTs as we see this as the way forward for sole trusteeship.

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The results of our 2020 survey on the sole trustee landscape

We surveyed PCST firms to understand the current market of schemes governed by sole trustees.

No. of PCST appointments by asset size[1]

"This boom in client demand makes sole trusteeship the fastest growing sector of our business. While the majority of our sole trustee clients are mid to small size schemes, we have seen a sharp increase in demand from large schemes, up to the low billions of assets. These are often the UK schemes of a multinational sponsor, looking for a consistent strategy and tactically agile approach to governance across all their schemes"

Capital Cranfield

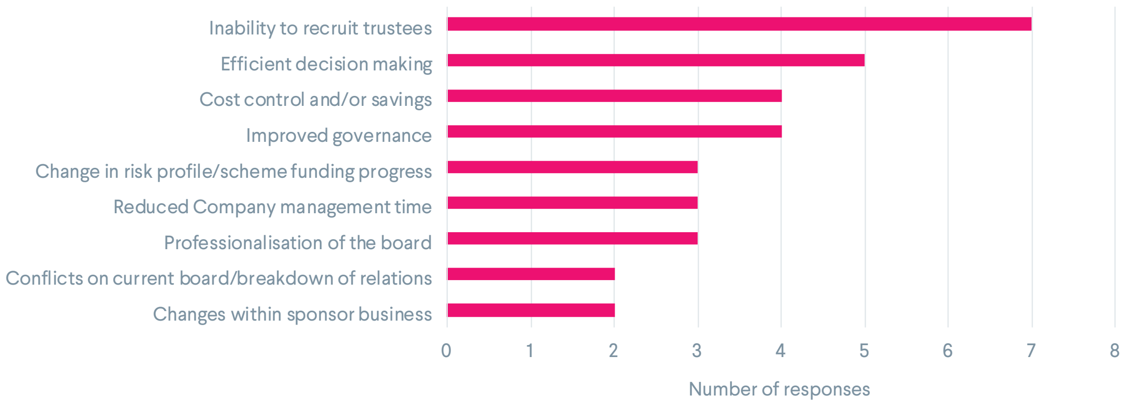
Sole trustees can be appointed to both DB and DC schemes however with the trend for smaller and medium-sized DC schemes to consolidate into Master Trust vehicles this typically means there are fewer DC schemes operating under sole trusteeship; as such, we focus here on DB schemes.

Historically, sole trustee schemes have been small in size, but the market has seen notable growth and a doubling of these schemes indicated in the last few years. With this growth in the number of appointments we have also seen growth in the size of these schemes including a small number of schemes in excess of £1 billion in assets. However, the bulk of the sole trustee market currently comprises schemes with less than £500m in assets.

We asked what key drivers PCSTs were observing for sponsors moving to sole trusteeship and it's unsurprising that many of our respondents noted the inability to recruit trustees. With most DB schemes closed to new entrants for around a decade or more, the number of members in a company's workforce is reducing over time making it harder to recruit member nominated trustees. Typically, schemes will draw member nominated trustees from the active and pensioner membership however schemes faced with a reduced recruitment pool do also have the option to open member nominated trustee positions to deferred scheme members or employees who are not members of the scheme too. To date however, widening the pool has in our experience been an option little taken up by schemes.

[1] Source: Hymans Robertson survey of 8 professional trustee firms

Why are employers choosing sole trusteeship?[1]



The reasons why employers are choosing sole trusteeship are issues which all schemes face and so it is not implausible that the size of schemes operating under sole trusteeship is likely to change too. Equally, sole trusteeship is not the only answer to these drivers and there is a spectrum of governance options that schemes should explore before moving to a sole trustee governance model.

Our view

Increased use of sole trusteeship amongst sub £100 million schemes is perhaps a reflection of tighter budgets for these smaller schemes and trustees needing to be more pragmatic in making increasingly more complex scheme decisions and in meeting governance requirements to maintain good practice.

Increased use of professional trustees who can bring broader experience of tackling these issues and a reduced need for some areas of advisory support such as provision of trustee training at scheme level can help this.

However, this needs to be balanced against the reduction in diversity and advisor challenge relative to a trustee board structure and possibly an increased lack of independence from the employer alongside diminishing voice for scheme members – these issues are explored in the next section.

In terms of member representation, our survey also showed that employers moving to sole trusteeship are largely being driven by the inability to recruit trustees. In our experience, employers who have opted to overcome this barrier by exploring options other than sole trusteeship (using engagement specialists or widening eligibility criteria) have been successful in increasing the trustee pool.

[1] Source: Hymans Robertson survey of 8 professional trustee firms

A closer look at the sole trustee model

The appointment of a professional trustee to any governance arrangement brings the benefits of depth and breadth of pensions experience, directly from the appointed trustee but also indirectly from the broader support at the professional trustee firm. For schemes that have not operated with a professional trustee previously, there will also be an associated cost of hiring a professional.

Possible benefits

The benefits can be further enhanced under a PCST approach, which often means the pension scheme is run more like a business, with regular engagement and activity rather than being limited to the quarterly trustee meeting cycle. The benefits of a PCST include:

- Greater strategic focus for schemes getting closer to end game strategies;
- Greater value for money as actions can be progressed more quickly and efficiently with often better visibility of progress;
- Reduced opportunity cost of taking company nominated trustees out of core business to act as trustees;
- Ability to be more nimble in capturing opportunities and reacting to risks; and
- Flexibility in sponsor engagement with PCST and looser meeting cycle.

The extent to which an employer will realise the benefits of this governance model will depend on a number of factors including: effectiveness of current board structure; proactivity of advisers; agreed way of working with PCST; and quality of scheme management information. In our view, for a scheme to be nimble and make strategic progress it is fundamental to have accurate, regular data feeds of scheme KPIs; a proactive mechanism for reacting to changes in KPIs and adequate resourcing to make and implement decisions when required.

Therefore, it will be important for employers to establish a good governance structure from the outset of the appointment of the sole trustee and scheme advisers. With the pension scheme being run in a way that is more akin to company management and corporate governance, the argument to appoint an equivalent to a Company Secretary role to drive the day-to-day scheme management can also be quite compelling.

Possible downsides

However, the sole trustee model has received some scrutiny as there are some downsides to the model, some of which can be mitigated to an extent. The two that have received the greatest attention are the level of diversity that can be achieved by a PCST and the resolution of conflict or independence from the employer.

Independence from Employer

Where PSCTs are the only trustee appointed by the Company this can call into question whether there is independence in the role. PCSTs will have professional requirements such as adherence with the sole trustee code and wider professional standards as well as fiduciary duties as trustees and continuing to operate under a strong governance structure will be important too. For example, supporting negotiations by taking appropriate advice and retaining a clear audit trail of trustee and employer dialogues through continued use of formal meetings. The APPT's voluntary code seeks to set out best practice on conflicts of interest.

Diversity

Diversity or perceived lack of diversity within a sole trustee structure can be a concern as fiduciary duties and material decisions in relation to the management of the pension scheme are being carried out by a single firm. This could mean there is insufficient challenge and input into decision making; with diversity of perspectives being widely recognised as an important part of quality decision-making.

The extent that a diversity of views can be achieved will depend the depth of the resourcing model of the professional trustee firm (we explore this further in the next section) and the advisory model in place, which will also influence the scheme decision making.

Is the sole trustee model less diverse?

Both a PCST structure and a Board structure can be "diverse" but the question is, which model achieves better governance and decision making? This will differ for every scheme as it will depend on the composition of the existing board but some factors to consider include:

1 The depth and breadth of societal demographics, skills and experience of the decision makers in the PCST team versus the trustees on the existing board

In 2016, the PLSA in its Annual Survey identified that on average schemes had more than 80% male trustees, with one quarter of trustee boards being all male. The Pensions Regulator also conducted its own research in 2016, which concluded that around a third of trustees are over 60 years old. By comparison, amongst the largest professional trustee firms by number of directors, around 60% of Trustee Directors are male and around 45% of support staff are male. We increasingly see professional trustees being recruited earlier in their career too, creating a shift in the age demographic.

PCSTs can come from a variety of career backgrounds including those with diverse backgrounds who have built experience as MNTs of different arrangements and moved into professional trusteeship as a career path; and those that have come from a variety of pension disciplines including actuaries, lawyers, investment advisers, covenant advisers or pension managers for example. Professional trustee firms can therefore draw on this pool of expertise to create teams with diverse skills and expertise albeit the range of skills and expertise might be more limited than those that can be drawn from an employer's wider population.

Accredited professional trustees are also required to carry out 25 hours of professional development annually to perform in their roles, which reduces the time required in relation to trustee knowledge and understanding but can result in industry Group Think having a larger impact on the management of a scheme. Some of the expertise of a PCST can also be found on lay or partially-lay trustee boards and additionally, the required skills and expertise for a trustee board also extends to "softer skills" such as negotiation and communication skills.

2 The number of Member Nominated Trustees currently on the trustee board

Member Nominated Trustees (and often company appointed trustees who are employees of the business) can have an important role to play on trustee boards, acting as a representative voice of the membership and the value of the "on the ground" feedback, which can feed into trustee decision making, should not be overlooked. Further the historic knowledge of pension scheme decisions, which sits with the board trustees, can be lost on transition if not documented well. To address this, often a PCST will work with an interim "consultative committee" (usually made up of the previous trustee board), which has no voting power but can be used to transition knowledge and maintain the on the ground feedback in the short to medium term.

3 The effectiveness of the current board and extent to which "Group Think" exists and decisions are influenced by a subset of trustees or advisors.

Having a diverse trustee board should lead to better outcomes where that board can demonstrate that it is operating effectively and that each trustee has equal share of voice to contribute to decisions made. The current effectiveness of the board will therefore hugely influence the change in the diversity balance on transition from a board to a PCST and influence the attractiveness of a PCST governance structure.

PCSTs can still bring diversity in terms of gender, career background and skills albeit the concern is often around the lack of member input, which can be mitigated to some extent or Group Think, which can also exist within a Trustee Board.

Professional corporate sole trustee providers

The APPT's Code of Practice

The APPT's January 2021 Code of Practice sets out requirements applying to professional trustees acting as PCSTs in addition to those that apply where they are appointed to a trustee board. Therefore, PCST providers now need to adhere to the Code, which creates some consistency and self-regulation of the market.

The Code was drafted by the APPT and a number of professional trustee firms contributed to its development to embed principles-based best practice around sole trusteeship. In particular the Code sets principles for the appointment process for sole trustees (including on conversion from a board appointment), best practice for independence and appropriate working relations with the employer and decision-making practices.

The Code places the onus on the sole trustee to ensure the employer has carried out appropriate due diligence in the appointment process and we consider later on factors that employers may wish to consider in appointing sole trustees. The PCST is a company appointment to act as trustee of the pension scheme but professional trustee firms will need to ensure sufficient independence from the adviser and that there is appropriate business conduct around reaching decisions with the sponsor, including appropriate management of actual and potential conflicts.

One of the key aspects of the Code, which means that the business model operated by professional trustee firms is often very similar, is the requirement to have at least two accredited professional trustees involved in all decisions and protocols for accelerating some decisions for peer review. In turn this means that the PCST model in many firms consists of a lead trustee with a second appointed trustee and some form of sole trustee governance board, which oversees the portfolio.

Ross Trustees' view

"Following the release of the professional trustee standards, the APPT's Code of Practice is both an important and welcome step towards raising the bar for the governance of sole trusteeship. Although a voluntary code, any firm considering the delivery of sole trusteeship should undertake a diligent assessment of its own working practices to ensure the principles within Code can be followed. The pensions industry, rightfully, does not regard it as appropriate for individual practitioners to deliver services in other professions, be it legal, actuarial or other consultancy, and therefore it should be no different for trustees, who are ultimately accountable for the delivery of pension benefits. In reality, sole trusteeship is now all about a team comprising of diverse and experienced professionals, with robust processes in place who deliver efficient outcomes for schemes and beneficiaries whilst working collegiately with the sponsoring employer. No doubt there will be further developments, perhaps even regulatory or legislative requirements, that necessitate and promote higher trustee governance and standards in due course."

We asked Ross how the Code of Practice has impacted their approach to sole trusteeship:
"Having been closely involved in developing both the Standards and the Code, Ross Trustees has been at the forefront of the evolution of sole trusteeship. Many of the measures contained with the Code have always been followed at Ross Trustees and a holistic team-based approach is firmly in place for all clients. The quality, breadth and depth of our resources demonstrates how an integrated service delivers efficiencies and optimal outcomes for not only small schemes but also for the very large £bn+ schemes too."

The market for sole trusteeship

There are a large number of professional trustee firms providing sole trustee services. These range from firms that have been set up to offer only professional trustee services, law firms who provide trustee services and in 2021 we saw a firm set up solely to provide sole trustee services. Some of these firms will be a single individual providing trustee services and therefore won't be able to operate under the APPT's Code as a PCST.

The APPT's Code may create some consistency over how sole trusteeship is delivered across the professional trustee firms and to some extent this could lead to few differentiators between their approaches. When looking at appointing a PCST you should have clear criteria for the successful firm and position any tender questions to focus on drawing out the key differentiators. We explore below some of the key factors we would consider when assessing professional trustee approaches:

Feature	Hymans view
Support team behind lead trustee	Whilst firms will have two appointed trustees they will additionally also have a support team working alongside the lead trustee(s) to support the delivery of services. This structure can, where executed well, create an almost "board like" structure within a professional trustee firm although the support team will generally not have decision making powers. Understanding the societal demographics and skills and expertise within the firm may support concerns about diversity.
Decision making processes	The APPT Code requires at least two accredited trustees to be involved in decisions to ensure appropriate challenge and diversity of thought. Some firms will go further than this having more directors involved in all decisions. Additionally, the extent to which the appointed trustees attend meetings may indicate the level of proactive challenge provided by the second or third trustee.
Level of engagement of peer review committee	Firms will have a peer review committee that any material decisions can be escalated to. Understanding a firm's protocols for when decisions are escalated for wider input and how proactively these committees oversee sole trustee arrangements will inform the level of diversity for better decision making and internal challenge for optimal outcomes. Asking for examples of where the use of these committees has led to improved decisions across their sole trustee portfolio or challenge has altered a scheme decision will test the effectiveness of these committees.
Portfolio level management	By definition, professional trustee firms can make some unilateral decisions across their sole trustee portfolio where sponsor agreement is not required. Some firms are doing this more proactively either in reaction to governance and operational matters in response to Covid-19 or in tackling more recent investment governance matters to ensure best practice across schemes in their portfolio in an efficient manner. It will be important that any decisions made in this way balance efficiency of implementation with the appropriateness at scheme level.

We asked two of the larger professional trustee firms to tell us about their approach to sole trusteeship.

How long have you been providing sole trustee services and how many schemes do you provide services to?

ITS: We have a long history as a PCST. Our client base of c170 schemes includes over 60 PCSTs ranging in size from below £10m to over £2bn. As a wholly independent firm owned by its directors, we have no influences that may bias our views or approach.

Capital Cranfield: we have been central to the efforts to improve and clarify the sole trustee market and are proud that our model for sole trusteeship has been industry leading for many years. Sole trusteeship is very important to Capital Cranfield. We are the largest provider of sole trustee services in the UK – with c.40% of our near 350 schemes being sole trustee appointments. 26 of our 45 Professional Trustees lead these sole trustee schemes.

Can you tell us a bit about how you create diverse teams?

ITS: We ensure diversity of input and thinking by having a varied team, from different areas of expertise, such as legal, actuarial, investment, finance, DC, administration and in house pensions management, as well as a broad cross-section of society, with almost 50% female directors and 20% of our staff are of BAME.

Capital Cranfield: Our client centric approach is central to how we build the teams for our sole trustee clients. We look to ensure that they comprise of colleagues with different skillsets and backgrounds appropriate to the particular needs of the client and their journey plan. This diversity of perspectives and thought is enabled through our culture of robust challenge between colleagues, which we believe leads to better decisions. The client team also has the skills and experience of the wider Capital Cranfield trustee body to draw on. This cadre, with 45 professional trustees from a variety of backgrounds, is the deepest and largest pool of talent in the country.

What is your approach to sole trusteeship?

ITS: For our PCST cases, we take a team approach incorporating accredited directors and a support team. The lead input comprises two peer directors as the principal representatives for each scheme. The named co-director is there for challenge, review, specialist technical expertise for projects and cover if required. They are fully conversant with scheme issues at all times. There is an additional experienced named support who can also liaise with the scheme secretary and advisers, who is either accredited or on a path to accreditation, and other support.

Our culture and business set-up, where we all know each other well, is ideal for team support and enables quick and informal input into matters, alongside more formal meetings. Additionally, our Client Executive forum comprising the whole ITS senior team meets regularly and is available for escalation, wider discussion and input at formal meetings and outside of these. Therefore, our model enables robust decisions to be made without delay.

ITS takes a sophisticated, dynamic approach, specific to the scheme and employer situation – not a “one size fits all” approach. We have always had an internal governance process and this readily enabled APPT code compliance.

Capital Cranfield: We continue to invest in the governance and support structures underpinning our offering. These investments include being the first firm to have appointed a dedicated Head of Sole Trusteeship, establishing a team of dedicated trustees to support our lead trustees, an internal governance team tasked with undertaking a rigorous independent audit of all our sole trustee appointments and the close oversight of our Risk Manager over all aspects of our trusteeship.

We will continue to evolve our offering in response to growing demand from clients – both new and existing - who wish to transition from a traditional governance to a sole trustee model – and from input gleaned during our regular workshops with advisors.

Appointing a sole trustee

Deciding to appoint a sole trustee often follows a governance review that considers a range of possible structures, such as maintaining a traditional trustee board (albeit perhaps reducing the size), moving to a sole trustee structure or considering a Master Trust solution where commonly one overarching body of trustees takes responsibility for all the schemes who participate (and who each sit in their own section of the Master Trust).

Often however, moving from a board of trustee to a sole trustee will be a gradual process rather than a sudden move. For example, a board may appoint a professional trustee, then gradually reduce to a smaller size, prior to going the whole way and appointing a sole corporate trustee. This gradual process has the advantage of allowing existing trustees to gradually leave the board as terms come to an end, or as priorities are re-evaluated, and can give sufficient time for member communications that introduce the concept of sole trusteeship and the timetable for the move, which can allow members time to ask questions and more fully understand the new governance model.

Planning for a longer-term move to sole trusteeship can be an important part of endgame governance planning. As DB schemes move closer to full buy-out or a low-dependency position, their governance needs change. The focus may shift to the detail of risk transfer solutions for example and often in these situations sole trusteeship models can work well, with professional trustees having the expertise and the governance structure being nimble enough to ensure informed and swift decisions are taken.

In practical terms, moving to sole trusteeship may require changes to the Trust Deed and Rules of the scheme and if the board isn't currently incorporated this will need to be arranged as part of the project plan. However, the difficult part of moving to sole trusteeship may rest in securing the buy-in of the existing trustees. Such moves therefore are often smoothest when the company and trustees work closely together and agree the plans for the change of governance structure.

"Whilst there are many drivers for moving to PCST and many positives of doing so [as discussed in this paper], not all schemes need to move to PCST. Many schemes are well run by lay trustees, representing member and employer interests and engaging collaboratively with employers, progressing schemes to a common goal. The old saying of "if it ain't broke, don't fix it" applies in the pension world as well."

ITS

"We would encourage any sponsor or scheme considering a change to analyse the advantages and disadvantages of the various trustee governance models, reach their own conclusions and choose the model that best meets their culture and strategy for the scheme. Their advisors can help with this process. We also have developed a paper, available on request, which details our experience of both the pros and cons of sole trusteeship and our recommendations on the optimal transition process."

Capital Cranfield

So what should you think about if considering a move to sole trusteeship?

1 Consider your options for improving trustee recruitment:
a move to sole trusteeship can be hard to reverse so thinking about how else to recruit trustees is a sensible first step

2 Explore the benefits and downsides of the full range of governance options:
this could be as little as improving the effectiveness of your existing board through to transition to a DB Master Trust

3 Review whether you're existing Trust structure facilitates the move:
if you decide to move forward with sole trusteeship, engage your lawyers to review your Trust Deed and Rules

4 Consider the sole trustee Code of Practice:
your appointed PCST will need to evidence compliance with the Code so it's worthwhile capturing this up front

5 Understand and agree the governance structure from the outset of the appointment:
understand your PCST and their advisory firm's approach to sole trusteeship to maximise the potential benefits of the approach

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