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Russell study reveals trustee governance challenges

LONDON, 3 March, 2011 - [Research](#) by Russell Investments has revealed three of the greatest governance challenges facing pension trustees today. These are: separating ultimate and immediate responsibility, balancing the speed and quality of decision making and objective self-evaluation.

Sorca Kelly-Scholte, Managing Director, Consulting and Advisory Services, comments: “Even though fund governance may seem straightforward in theory, our research highlights that it can be challenging in practice. The majority of the issues raised at our recent roundtables coalesce around three broad themes and there are practical steps that pension funds can take to address these concerns.”

Challenge 1: Separating ultimate and immediate responsibility

The challenge: The research demonstrates that it can be difficult for trustee boards to find the right balance between ultimate responsibility for a decision and the ability to delegate immediate responsibility for that decision to someone else. This can lead to inappropriate delegation, and more commonly, lack of appropriate delegation for reasons such as fear of loss of control, not meeting fiduciary obligations or falling foul of statutory obligations.

Russell's response: A key way to overcome this challenge is to understand the non-executive role of a trustee. In particular, training should be focused on helping trustees to understand the practices and knowledge needed to assess, question and challenge analyses presented to them. Today, too much training is focused on building detailed technical expertise. Likewise, trustee reports should enable the trustees to focus on the few decisions that affect 80% of the outcome. This suggests a dashboard format, for example, using a traffic light protocol – with the ability to probe further wherever the board feels it necessary.

Challenge 2: Balancing the speed and quality of decision making

The challenge: Not all trustees are satisfied that their boards effectively make timely decisions, especially over the last couple of years. This echoes the findings from Russell's 2009 survey which found that “40% of respondents were not confident in their ability to respond quickly to new situations“. Reasons for this include unclear or poorly designed governance structures; lack of trust; or lack of relevant data.

Russell's response: Taking a different approach to maintaining and periodically reviewing contingency plans and being prepared to execute them if necessary will help trustee boards to react quickly to future crises and opportunities.

They should monitor for triggers of pre-conceived action plans, not figure out what to do after an event occurs. Trustees should also periodically test the integrity of their data and policies, so data and records can be called upon at short notice.

Challenge 3: Objective self-evaluation

The challenge: Unlike corporate boards, many trustee boards are not evaluated objectively for many reasons including: the difficulty of separating skill from luck, mistaking time spent in making a decisions for quality of the decision, lack of clear accountability, and natural behavioural traits, such as overconfidence and loss aversion.

Russell's response: PLC boards have introduced self-evaluation, with an external evaluator every three years. It makes sense for trustee boards to adopt the same practice as that of the sponsor. Not only will this help to provide ownership to any new individuals who become involved, it also helps to prevent governance structures becoming stale. Trustees don't need to use an external evaluator, but using an external provider that is honest in their opinions provides a truly objective and independent view, and can make any changes easier to justify.

Sorca Kelly-Scholte concludes: "While our research reveals that trustees almost take for granted that good governance is more likely to lead to good outcomes, they should not underestimate the potential practical challenges of implementation. The difficulty of distinguishing between ultimate and immediate responsibility and typical behavioural barriers, such as overconfidence, remain perennial challenges. Trustees should be prepared for periodic objective self-evaluation, using independent parties if necessary, and should not see this as self blame. An easy starting point is looking at trustee training and trustee reporting, which should both be focused on non-executive objectives rather than executive functions. We also suggest using our benchmarking tool as a means of highlighting potential areas for discussion and review."

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Notes to editors

The research is based on the findings of a series of roundtables held with trustees and senior staff of large pension schemes on the subject of investment governance. This is the third in Russell's series of research papers designed to help trustees evaluate their decision-making structures.

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