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The problematic nature of UK pension fund regulation: Performing governance at the expense of innovation

Gordon L. Clark
Smith School of Enterprise and the Environment, Oxford University, UK

Abstract
At the heart of UK pension fund regulation are quasi-compulsory codes of practices and tests of pension fund trustees' competence. This regime of 'soft' regulation focuses upon the 'performance' of governance and is intrusive in terms of expected behaviour and board decision-making. Framed by defined benefit pension obligations in the private sector, it lacks rigorous standards of value when applied to defined contribution pensions. As such, pension 'adequacy' is discounted by the premium placed on performing governance in the market for financial services. The UK pension regime has hit a dead-end being neither fit-for-purpose in a world of technological disruption and financial turmoil nor capable of empowering those funds willing and able to innovate in the best interests of participants.

Keywords
Best practice, governance, finance

Pension reforms in the UK and across the OECD and beyond have reinforced the role of occupational pensions in realizing 'adequate' retirement incomes given population ageing and claims on current and future government spending (Disney, 2016; Ebbinghaus, 2011).

Corresponding author:
Gordon L. Clark, Smith School of Enterprise and the Environment, Oxford University, South Parks Road, Oxford OX1 3QY, UK.
Email: gordon.clark@smithschool.ox.ac.uk

Whereas social security programmes are typically full or partial pay-as-you-go systems, occupational pension schemes in the Anglo-American world normally collect and invest participants' contributions in order to 'pre-fund' future benefits and obligations. As such, UK pension funds are important financial *and* social institutions; how they are managed and regulated can make an appreciable difference to plan participants' retirement income and national welfare (Clark and Monk, 2017).

The nature and scope of pension fund regulation tends to follow country-specific regulatory practices and traditions notwithstanding shared imperatives and policy prescriptions (Dixon and Sorsa, 2009). Nonetheless, it is possible to identify commonly held regulatory instruments and modes of enforcement distinguishing, for example, continental European from Anglo-American legal traditions (see La Porta et al., 1998; Soper, 1984). More broadly, multi-lateral organizations such as the OECD, the World Bank and the United Nations have sought to encourage best practice in fund governance by the development of international standards and case studies of best practice. For critics, however, moves towards international standards is indicative of the pervasive influence of neoliberalism and the incorporation of 'private' financial interests into national welfare states (Engelen, 2003).

UK pension regulation is, notionally, a principles-based regulatory regime that reflects the post-war evolution of the British regulatory state (Moran, 2003). By contrast, US federal regulation of private pensions is based upon statute, rules and regulations. In combination, the relevant US federal codes run to thousands of pages. While both countries share a commitment to funded workplace pensions whether defined benefit (DB), defined contribution (DC) or hybrids, it is believed that funded private pensions are regulated in quite different ways. It is argued here that appearances are deceiving. In effect, the UK pensions regulator has instituted a 'hard' regulatory regime in the guise of a 'soft' regulatory regime – defined as a mode of practice that involves 'continuous, self-organizing improvement (in) regulatory practice' (citing Veldman and Willmott, 2016: 222 who refer to the UK principles and practices of corporate governance).

The emergence of the 'soft-regulation' regime is explained by reference to the problems associated with reliance upon the common-law principle of fiduciary duty. The paper then focuses upon the pension regulator's codes of practice, covering topics such as the funding of plans, conflicts of interest and the like. This is followed by an account of the importance attributed by The Pensions Regulator (TPR) to governance and management in relation to the golden-rule of fiduciary duty (see Donald, 2019). It is also noted the regulator has strongly 'encouraged' trustees to undertake training via on-line tests of knowledge and understanding. In combination, the UK pensions regulator has sought to 'modernize' pension fund governance through a process of in situ reform (see Benson et al., 2011 on related developments in Australia).

Nonetheless, it is argued that the regulator's model of fund governance and management has placed a premium on the performance of governance rather than the substance of governance: that is, the constituent elements and ritualized acts of collective decision-making that sustain UK pension fund governance rather than the delivery of adequate pensions (Dacin et al., 2010).[1] The process of deliberation, who decides and doesn't, what is decided and when it is decided dominates the life of UK pension funds to the cost of plan participants. Given the uncertainties enveloping the 'production' of pension benefits over the long-term, it is arguable that the regulator and many pension fund boards find performing governance preferable to being held to account for the performance of governance.

Taking the argument further, the regulator has been slow to address the challenges associated with the emerging importance of DC pensions notwithstanding the recent publication of a discussion paper on DC regulation (The Pensions Regulator, 2020b). In the penultimate section of the paper, it is suggested that the regulator's model of pension fund management and governance has failed the toughest test of efficacy: adaptation to disruption – technological innovation and recurrent financial crises. Whatever the virtues of a competent and well-governed pension fund whether DB or DC, the technological revolution and repeated financial crises have so disrupted the performance of the UK pension fund system that it has been brought to an unspoken crisis.

Some assessments of the performance of the UK pension fund sector have focused on changes in offered pension benefits (see Kaifala et al., 2020). Others have focused on inequalities in pension provision including the lucrative nature of corporate executives' DB pension benefits (see Waine, 2008). Like Tilba et al. (2016), I take an 'inside' perspective on what drives UK pension fund governance. The critique presented herein is informed by more than a decade of annual consultations at Oxford University with senior pension regulators from around the world, engagement with large and small Australian, Canadian, European, UK and US pension funds, and research on UK pension trustees' decision-making competence (Clark and Monk 2017; Clark et al., 2006).

The UK pension fund sector

In 1980, the UK Royal Commission on Banking Institutions noted that pension fund assets were a small segment of the UK financial sector but were likely to grow over the coming decades (Wilson Report, 1980). At the time, it was thought that pension fund assets could increase from about £15 billion in the late 1970s to £150 billion at the turn-of-the-century. In fact, recent estimates by the Office of National Statistics (2017) put the value of workplace pension entitlements at approximately £3.7 trillion. While the sector is not fully funded, in 2017 the value of pension assets stood at approximately £3.4 trillion.[2]

The 1970s and the early years of the 1980s were dominated by economic and political crises – manufacturing and mining industries that were brought into the public sector through the Second World War were increasingly uncompetitive in the re-emerging global economy. Arguably, post-war austerity had constrained public sector and private sector innovation and investment in new production systems and modes of management. In terms of retirement, many workers relied upon what is now known as the Basic State Pension (BSP) and formal and informal pension payments by employers. As it stands, the BSP is based on years of employment not earned income and is paid from government revenue. It is designed to provide individuals a pension benefit at, or above, the notional UK poverty level.

At the time of the 1980 Royal Commission, larger rather than smaller employers provided DB pensions. Some of these were found in government-owned companies like British Airways and British Steel. As these companies were returned to the private sector, many utilities were privatized along with their pension obligations. These pension funds tended to be partially funded rather than fully funded and were governed by common-law conventions notably fiduciary duty. Thereafter, governance-related scandals brought into the open conflicts of interests when corporate officers, union officials and trustees responsible for workplace pensions are caught-up in the market for corporate control, acquisitions and investment; witness the Robert Maxwell – Mirror Group case (Thomas and Turner, 2001).[3]

The issue of workplace pension security was brought to UK Parliament by the Labour government in the early 2000s, informed by a report by the Parliamentary and Health Service Ombudsman (2006). This issue and related initiatives have underwritten the policies and procedures of TPR. In retrospect, as important was the recognition of significant shortfalls in private sector pension provision by sector, size of company and occupation.[4] A series of studies and a government commission of inquiry into the nature and scope of the problem and its possible resolution were important in framing UK pension policy for the Blair government and beyond (see Pensions Commission, 2005).

With bipartisan support, the UK government sought to extend pension coverage across the private sector. One element in this policy was the establishment of the National Employee Savings Trust (NEST) – a not-for-profit multi-employer DC pension fund focused upon securing the participation of small and medium-sized employers. Informed by research findings from behavioural economics and cognitive science (see Benartzi and Thaler, 2004; Thaler and Sunstein, 2008), in 2010 the newly elected Conservative government took forward the legislation requiring all employers to automatically enrol (and re-enrol) their employees into a workplace pension while providing participants the option to opt-out if they desire. Hence, UK pension policy shifted from 'choice' to 'paternalism' in a gesture of bipartisan support.

Recognizing the challenges associated with the risks of funding of DB pensions, the private sector aided and abetted by the UK financial services industry has moved from DB to DC pensions (Kaifala et al., 2020) – a move encouraged by lower employer contributions and facilitated by low rates of unionization in the retail, commercial and finance sectors. Private sector employers have been reluctant to offer and/or maintain DB pension benefits because of regulatory requirements as to the funding of related financial obligations and the mandatory participation of employers in the Pension Protection Fund (PPF) (where employers' annual premiums are risk-related). DB pensions remain in the private sector but are available to a privileged few (Waine, 2008). Their significance in terms of coverage rates and the volume of DB assets is declining in absolute and relative terms.[5]

Many public-sector DB plans remain open and are not subject to TPR or the PPF. To the extent that these plans are subject to government oversight, the National Audit Office has provided regular data on funding levels while the relevant central government departments – Local Government and Communities and Treasury – have sought to enhance the accountability and efficiency of the Local Government Pension Scheme (LGPS) and local pension scheme boards. The most significant reform, in this respect, came with the pooling of local government pension assets and liabilities into the LGPS in 2015 and the development of the LGPS as a major UK pension fund.

This brief history of UK workplace pension provision does not do justice to the economic and political challenges of the last decades of the 20th-century (see Pemberton, 2004). Nonetheless, there are three threads of policy and innovation that inform discussion in the following sections. First, workplace pensions are fundamentally important when it comes to determining an 'average' worker's retirement income. Second, while it appears that the UK government has adopted pension institutions and benefits like the USA, regulation remains infused with common-law conventions and the instruments of soft regulation. Third, and notwithstanding attempts to ensure the integrity of private sector pensions, the transition from DB to DC pensions has put pension adequacy on the policy agenda.

Soft regulation: codes of practice

Twenty years ago, the principle of fiduciary duty combined with the Pensions Act would have been deemed enough for the governance and management of pension funds (Donald, 2019). Competing claims on the responsibilities of pension fund trustees and the complexity of pension fund decision-making have blunted the functional significance of this principle (Tilba and Reisberg, 2019; Tilba et al., 2016). Crucially, TPR has established codes of practice designed to guide pension administrators' and trustees' decision-making on specific issues and with respect to the integrity and security of the UK pension system.

As of April 2020, there were 15 codes of practice. The first two codes were published in 2005 and the most recent code of practice, on master trusts, was published in 2018. The first code of practice dealt with the obligations of administrators and trustees to report breeches or violations of pensions law, and the second code of practice gave guidance as to the obligations on administrators and trustees to give TPR 'early warning' of likely problems in their plans. There are codes of practice that deal with the treatment of early leavers from pension plans, the obligations on administrators and trustees to notify the regulator of late payments of contributions in occupational and personal pensions, expectations as regards the robustness of internal controls, mechanisms of dispute resolution and procedures relating to the modification of existing pension rights.

There are also codes of practice relating to the funding of DB pensions, the appointment of member-nominated trustees (MNTs), trustee knowledge and understanding, the governance and administration of occupational pension funds and public service pension funds and the authorization and supervision of Master trusts. Some codes of practice are about policies and procedures – for example, the appointment of MNTs. Other codes of practice are about the funding of pension obligations including early warning of shortfalls. Some codes of practice have to do with the organization and management of UK pension funds. In sum, these codes of practice provide a 'map' of key issues in the UK pension fund sector and resonate with the experience of other OECD countries.

Accompanying each code is a brief commentary to the effect that the code is 'not a statement of the law' so much as a statement of best practice consistent with the relevant requirements as set-out in the Pensions Act. TPR also notes that the codes of practice are not regulations or rules that *must* be followed in all instances or circumstances; allowance is made for variations in interpretation and application. However, TPR states that any deviation from a stated code of practice must meet in substance the 'underlying' legal requirement or requirements.[6] The regulator indicates that penalties may be applied if a variation cannot be justified and it notes that any judicial determination on related matters would necessarily take into account the relevant codes of practice.

The presumption in favour of the regulator's codes of practice is reinforced by the fact that UK pension funds normally employ legal advisers to inform administrators and trustees on pension-related matters. These advisers typically provide regular briefings to trustee boards on the substance of the codes of practice and current interpretations of their meaning and scope as reflected in advice from TPR, case law and industry practice. There are relatively few UK law firms that specialize in pensions law and regulation; the advice given to one fund about the codes of practice is often the advice given to other pension funds on related matters. Adhering to industry convention is cost-effective and is justified time and again by what 'other' funds do in similar circumstances.

There have been few cases brought to the courts contesting TPR's codes of practice and/or their application in specific instances. This can be explained in various ways. The fact that compliance is voluntary, notwithstanding the 'threats' associated with non-compliance provides the regulator with 'cover' from litigation. MNTs are typically poorly informed about pension rules and regulations and are likely to defer to legal advisers on these matters. Employer-nominated trustees are unlikely to challenge legal advice on these matters because they are wary of bringing attention to their employer – plan sponsor. In any event, independent trustees are unlikely to raise objections because of their interest in continuing in their role within the UK pension industry.

It is arguable that these codes of practice are reactions to instances of failure or systemic problems identified in the UK pension fund sector. Whereas the framing and passage of legislation in the UK is cumbersome and time-consuming, taking years rather than months to resolve, TPR is charged with the responsibility of ensuring the integrity of the UK pension sector on an ongoing basis. As such, introducing a new code of practice relevant to a recognized issue of importance can be quicker and more effective than passing on the issue to some future and revised Pensions Act.

Nonetheless, there are other ways of regulating pension funds. For instance, TPR could regulate via a robust licencing system when pension funds are established and through a regular re-licencing system for existing funds that would be a moment for the regulator to intervene on issues relating to the integrity and efficacy of fund decision-making. In doing so, TPR would have the opportunity to re-consider the performance and cost-efficiency of such funds in the light of participants' welfare and the integrity of the system.

Soft regulation: governance and management

Trust is one of the foundations of English common law (Atiyah, 1979). It is to be found in Anglo-American legal regimes that have blended the heritage of English common law with constitutional frameworks sustained by statutes, regulations and adjudication. In the UK, fiduciary duty and trust law are intimately related wherein the former provides guidance as to roles and responsibilities of trustees and the latter provides a formal framework as to the expression of those roles and responsibilities. This logic is expressed in The Pension Regulator's codes of practice (#8, #9 and #13).

Fifty years ago, fiduciary duty and trust law were less formal and were expressed in behavioural norms and conventions underwritten by case law. Whereas the obligations on fiduciaries were widely acknowledged, it was not nearly as clear as to who should be or could be trustees. These issues were crystallized in the Mineworkers case (*Cowen v Scargill*). Here, the High Court held that the Mineworkers union president had violated fiduciary duty in the service of the union's interests. Scargill, the President of the Mineworkers Union and Chair of the Board of the related industry pension fund, dominated the management and investment policy of the fund.[7]

By convention, fiduciary duty is performed through a board or some other formal or informal organization which has as its principal purpose the interests of beneficiaries. Historically, this took many forms some of which were found in existing organizations constituted for other purposes while, in other circumstances, there were special-purpose committees or external entities that took responsibility for the interests of beneficiaries. As part of its legislative framework, the Labour government elected in 1997 sought to protect the interests of pension fund beneficiaries. In effect, the court cases noted above along with the Labour government's legislative framework institutionalized pension fund boards as separate legal entities albeit hosted, in most cases, by their sponsors.

Here, TPR sought to formalize the governance of these organizations in the following ways. In the first instance, #8 requires pension fund boards to have at least one third of its trustees be MNTs, erring on the upside rather than the downside (e.g. 4 out of 10 board members). The code of practice is clear as to who is eligible to be an MNT, how they are nominated and selected and the principles and procedures underpinning the selection process. In the second instance (#9), the regulator requires funds to have 'adequate internal controls'. If not entirely prescriptive, the regulator requires trustees to 'establish and operate internal controls which are adequate for the purpose of securing that the scheme is administered and managed' according to its rules and legal responsibilities.

In the third instance, in 2016 TPR introduced a revised code of practice (#13) applicable to the governance and management of trust-based pension schemes that provide money purchase benefits. It also provides a comprehensive statement as to the roles and responsibilities of trustees, the principles by which they should behave (e.g. honesty, integrity), their responsibilities for members and beneficiaries, the requirements attending to professional trustees and the process whereby board chairs are appointed. Basically, TPR has sought to frame the governance of pension funds in terms consistent with public and private corporations. While significant differences remain, especially as regards the representative role of MNTs, it is not surprising that numerous pension funds have been incorporated.

Incorporation has certain benefits. The company can become the trustee and shoulder the legal responsibilities attending to the role while board members who are otherwise trustees are not directly responsible for the welfare of members and beneficiaries. They are, nonetheless, responsible for the governance and administration of the trustee company. Incorporation also facilitates the writing of contracts with the providers of administrative services, related management functions and investment managers. In this respect, the companies that sponsor pension plans can, in effect, be written out of service agreements and replaced with companies that provide these types of services to themselves, other pension funds and the investment management industry.

As well, TPR has allowed for and/or facilitated the professionalization of UK pension funds. It has done so using codes of practice to institutionalize best practice. In doing so, it has transformed pension fund boards, governance procedures and management processes into 'services' that map onto the UK professional services industry which attends public and private corporations. At the same time, it has allowed pension fund trustees and boards of management to persist with their own arrangements subject to oversight as to their fit with the latitude or scope for variations provided in codes of practice and their obligations under pension law.

Looking back to the governance practices of 40 or 50 years ago, it is remarkable how different UK pension funds are compared to the informal and often compromised arrangements as represented by the Mineworkers and the Mirror Group cases. Soft regulation focused upon the constitution of pension fund boards, administrative arrangements and practices and the decision-making protocols that underpin the production of pension benefits has been used to enhance the professional standing of these organizations. Enabled by statute, TPR has made modernization of the UK pension fund sector its raison d'être.

Soft regulation: competence

One of the most important codes of practice is 'trustee knowledge and understanding' which came into force in November 2009 (The Pensions Regulator, 2009). In April 2015, amendments to the pensions act required chairs of pension fund boards to explain in their annual reports how each trustee meets the requirement that they have appropriate knowledge and understanding of their roles and responsibilities. As well, trustees' combined knowledge and understanding and the advice from relevant advisors enables them to exercise their trustee responsibilities.

As with the other codes of practice, this code is deemed advisory with guidance as to how pension fund trustees can meet legislative requirements as to their knowledge and understanding of their roles and responsibilities. The code allows for trustees to demonstrate knowledge and understanding of their roles and responsibilities in other ways – through professional experience, formal education and/or a demonstrated record of engagement with the issues. In practice, however, this requires pension funds to make submissions to TPR on behalf of those trustees that would wish to bypass the regulator's tests of competence. Recent experience suggests that this is a slow and cumbersome process.

The 'Trustee toolkit' is an on-line education and testing regime designed to cover 11 key issues and tests trustees' knowledge and understanding of these issues through sets of questions with multiple answer options. The regulator provides an explanation of each issue, asks questions to test trustees' comprehension of the issue, and depending upon whether trustees answer those questions correctly or incorrectly records whether the trustee has passed the module with distinction, has passed the module, or must reread the explanations and, again, attempt to answer the questions. The regulator also indicates the likely time needed to learn the relevant material and then pass the test. In many cases, the expected time needed to complete each module is 60 minutes or more.

Topics covered include the nature and purpose of pension schemes, the roles and responsibilities of trustees, running a pension scheme and pensions law. More challenging topics include funding DB schemes, investing the assets of DB and DC pension schemes and funding long-term obligations (relevant to DB schemes). In some cases, these modules can be expected to take at least 120 minutes to complete. As a trustee enrols in this programme, he or she also identifies the scheme or schemes where they act as trustees. Upon successful completion of the test regime, TPR reports to the relevant scheme administrator that the trustee has successfully completed the test regime.

At one level, this test regime demands time and effort (concentration) by trustees along with some forbearance when dealing with mundane issues. Nonetheless, for those trustees that come to the role without relevant experience this test regime can be daunting. In many cases, MNTs who come from the factory floor or from the office may not have encountered the concepts and forms of English expression that underpin explanations of pension schemes, trustees' roles and responsibilities and pension law (for example). While it is not suggested that the topics and their explanations are deliberately framed to exclude rather than include, it is apparent that this test regime is a barrier to entry.

At another level, motivated trustees conscious of their responsibilities to the fund and to the chair and the administrator of the fund are likely to complete the test regime even if it requires, time, advice and consultation. However, it is arguable that the test regime does little more than test for competence – that is, 'having the necessary ability, knowledge, or skill to do something successfully' (Soanes and Stevenson, 2004: 353). Further, in some cases, it may be a little more than a demonstration that the trustee has the forbearance to complete the test regime. And, in other cases, it may become a long, drawn-out process where those that find the test regime difficult may not be able to complete the test regime. In principle, the test regime is yet another device designed to 'level-up' the average pension fund board by improving basic knowledge of key concepts and ensuring that trustees understand the terms and concepts used when discussing relevant issues and making decisions.

A shared vocabulary is not enough for board members to make effective decisions with respect to agreed goals and objectives. It is only helpful if anchored by a shared understanding of their meaning, applicability in relevant circumstances and the likely consequences that would flow from the deployment of these terms and concepts in case-specific decision-making. Here, trust is an important factor along with experience in applying these concepts to decisions that problematic in terms of the consequences for their fund and for the welfare of participants (see generally De Jong and Elfring, 2010). Otherwise, a shared vocabulary may become a means of legitimating decisions taken by those that dominate board proceedings.[8]

The challenge facing many pension fund boards is that of ensuring decision-making on key issues transcends the commonplace and customary behaviour. This is most obvious when it comes to investment matters that are subject to market risk and uncertainty. It is also deeply embedded in decisions taken when designing a DC pension scheme including contribution levels, investment options and service providers. On these issues, and others, there is a premium on expertise not just competence.

Performing governance

Each new code has been absorbed by the UK pension fund industry aided and abetted by briefings by advisers and consultants. Taken separately, the burden imposed on trustee decision-making has been modest even if the burden imposed on administrators in developing appropriate reporting procedures has been more significant. This policy regime has added significant administrative costs to the governance and management of pension funds. Consequently, plan sponsors increasingly distinguish the costs associated with the governance and management of their pension plans from their underlying business and operating costs.

For trustees, the costs and consequences of the pension regulators' codes of practice have been recognized in the increasing formalization of pension fund decision-making across a range of issues. As well, advisors and consultants claim an increasing share of the time allotted to pension funds' deliberation and decision-making by virtue of their regular updates on the status and scope of the regulator's codes of practice and related matters. For trustees who have come to their role in recent years, these codes of practice are hardly visible in the proceedings of their pension funds except in the briefings provided by advisers and consultants. As such, they take as *given* the ways in which UK pension funds 'perform' governance and management.

The codes of practice have also 'ritualized' pension fund deliberation – reflecting a prescribed form of deliberation rather than focusing upon trustees' substantive responsibilities. As a result, the agendas of pension fund board meetings along with their constituent sub-committees have become preoccupied with the *process* of deliberation rather than the content of decision-making. In effect, the agendas of meetings are framed around a pre-arranged 'script' which reflects, in large part, the codes of practice and the routine ways in which reports are received and approved. The agendas of board meetings have become longer, being dominated by items that require acknowledgement of the actions taken by administrators and providers rather than decision-making itself. Meetings are more often 'performances' than venues for deliberation, strategy and action.

To illustrate, TPR's codes of practice place a premium on risk management matching the consulting industry's enterprise-wide risk management systems and checklists. This issue deserves attention, given the reliance of many funds on management and operating systems that are system-critical and require scarce management and resources. The codes of practice require assessment of the integrity and functionality of risk management systems, the identification of issues of concern, and reports on how identified concerns may be ameliorated or resolved. Pension fund trustees are typically asked to approve these reports and progress to date. Given the myriad of issues relevant to pension fund governance, this item can take up scarce time and effort by board members.[9]

The codes of practice have tended to shift the selection of issues for Board deliberation from fund administrators and the senior members of trustee boards to advisors and consultants. In part, this shift has been prompted by the realization that the codes of practice require explicit acknowledgement of the quasi-legal status of the codes as well as their current interpretation and application in practice. Advisors and consultants are often better-placed than boards to carry through actions relevant to codes of practice than boards because of their knowledge of the regulator, the financial services industry, and similar-placed pension funds. At one level, this is a pragmatic response to the obvious. At another level, funds increasingly *rely* upon advisors and consultants to take the initiative on these issues.

To illustrate, an important issue has to do with conflicts of interest-amongst administrators, trustees, consultants and advisers and service providers. At one level, conflicts of interest are inevitable in that administrators and trustees are normally employed or have a direct relationship with plan sponsors. Consultants and the advisers that provide services at a price, also value highly the continuity of their relationships with clients. Note, TPR requires funds to keep the register of conflicts of interest as well as gifts and entertainment that may accompany commercial relationships with service providers. Pension funds typically rely upon their legal advisors to assess the significance of identified conflicts of interest and provide advice as to the conflicts of interest that should be reported to the regulator.

In the third instance, the codes of practice are, typically, about how trustees should perform their roles and responsibilities rather than the outcomes or quality of performance. The premium placed by the regulator on the process of deliberation has been to focus on the procedures to realize results rather than to focus on desired outcomes and thereby adapt and/or adopt efficacious procedures to achieve those outcomes. In effect, the premium on process implies that the integrity of individual pension funds and the UK pension fund sector depends upon the principles and practices of 'procedural rationality' as conceived by the regulator. Focus upon procedural rationality allows the regulator and the government to sidestep questions of pension adequacy.

To illustrate, it is notable that the code of practice relevant to the design and implementation of money purchase (DC) pension schemes focuses upon roles and responsibilities of trustees in relation to the assessment of pension products rather than setting standards by which to judge the quality or value-for-money of competing DC pension products. By focusing on procedures and responsibilities, TPR absolves itself of responsibility for setting rules and regulations as regards choosing a DC provider and whether the services provided meet accepted standards of value-for-money and, ultimately, pension adequacy. Given market concentration in the industry, and the lack of agreed standards as to how to judge the performance of DC pension products, this leaves funds ‘hostage’ to the market for financial services (see, generally, Gabaix and Laibson, 2006).

Plan sponsors and participants bear directly or indirectly the costs of inefficiency and poor decision-making in higher than average charges and in lower paid benefits and/or different kinds of benefits (DB and DC pensions). There is a role for the pension regulator to set standards including value-for-money in the provision of pension investment and management services. Equally, there is a role for TPR to encourage innovation in related products and processes.

Performance of governance

The toughest test of any regulatory regime is not found in the implementation of accepted principles and practices across a sector but in how it performs in the face of disruption and unexpected events (Gans, 2016). Here, we focus upon three aspects of the UK regulatory regime which separately and together discount the capacity of UK pension plans to respond to disruption. These elements put at risk the long-term viability of the UK occupational pension system. In order, these issues are the adaptiveness of pension fund governance to disruption, trustee expertise and the ability of funds to frame and implement investment strategies that take account of the herd mentality of the financial services industry.

Disruption can take many forms, some of which affect the global economy whereas other kinds are found in the irrationalities of a sector and its constituent elements. The revolution in information technology is an instance of the first kind of disruption whereas the failure of a type of pension benefit is an instance of the second kind of disruption. Information technology is an opportunity to remake fund governance and the relationship between sponsors and beneficiaries given the growing importance of DC pensions (Clark, 2020). Even so, many pension fund trustees are risk-adverse; a human predisposition found in psychology laboratories (Kahneman and Tversky, 1979) and across many societies (Weber and Hsee, 1998). As such, TPR does not *reward* innovation, nor does it encourage the appointment of trustees with unusual skills and expertise.

The driving forces behind the technological revolution are, by now, readily identifiable even if the nature and scope of its trajectory and impact require expert advice and insight (see Monk and Rook, 2020). Similarly, financial crises tend not to be serially correlated such that their timing, causes and consequences are difficult to predict with any accuracy (Barro, 2006; Weitzman, 2007). More problematic is the possibility that market risk and uncertainty is now systemic to developed markets (Haldane and May, 2011). Encountering such crises can prompt sudden shifts in investment strategy (over-reaction) and/or a strategy of ‘sitting-it-out’ market volatility (under-reaction). Either way, the average pension fund takes the ‘hit’ while other, more nimble investors, make money out of less sophisticated investors (Lo, 2019).

For UK pension funds, these events include the late 1980s recession, the ERM crisis of 1993, the Asian financial crisis of 1998, the dot-com bubble of 2001/2002, the global financial crisis, the euro crisis and now the COVID 19 pandemic. These types of events are treated by funds as unexpected ‘surprises’ that disturb investment strategies *but* only alter investment plans after the fact. Their accumulated impact on the solvency of DB pension plans and the account balances of DC pension plan participants are such that many retirement plans have been systematically and adversely affected over the longer-term. Many UK funds have neither the governance flexibility nor the expertise necessary to adapt investment strategies to take advantage of market under- and over-reaction (Glode et al., 2012; Seo and Wachter, 2019).[10]

Knowledge and understanding are less important in these situations than expertise (Kahneman, 2011: 10–11). More specifically, Harvey (2012) and Hogarth (2001) note that expertise is domain-specific, acquired at the interface between judgement and knowledge, and is open to re-calibration in the light of actions and experience. Experts look-through the representation of issues to underlying patterns and processes seeking information that confirms or not judgements made about cause and effect (Clark et al., 2006). Trustee knowledge and understanding is, no doubt, useful in periods of economic and financial stability. But it may give trustees a false sense of security and, worse, it may encourage trustees and advisers to look for signals of stability where, in fact, following convention is likely to amplify or reinforce the costs of crisis (Wiss, 2019).[11]

In the lead-up to an economic and financial crisis, boards and sub-committees often ignore signals of impending market turmoil and absorb the time that could be used to make contingency plans and seek advice from advisers outside of routine reports on asset allocation and investment performance. The capacity to respond to events as they unfold can be absorbed by meeting timetables, reporting schedules and the routine management of the business of pension plans. Business as usual tends to be reinforced by the triannual funding assessment which can take up to 18 months to initiate and complete against the changing parameters of the regulator. Whereas analysts suppose that UK pension funds have an opportunity to act as long-term investors, they end-up chasing markets by virtue of TPR's policies and requirements (compare Ivashina and Lerner, 2019).

Locating decision-making with boards populated with competent representatives of sponsors and beneficiaries may, in effect, go against the best intentions of TPR and those that take responsibility for retirees' welfare. If UK pension funds are to be effective in responding to unanticipated disruption, they may have to step away from the conventional model of UK fund governance. One alternative would be to adopt the continental European model of corporate governance locating representatives of sponsors and beneficiaries in a supervisory board while locating operational matters with management boards buttressed by domain-specific expertise subject to appropriate levels of oversight.

This is one model amongst other options. Another option is to separate operational matters including the interface between plan members and pension fund administration as well as oversight of the investment management process from direct responsibility by boards and sub-committees. The outsourced chief investment officer model has made inroads in the UK pension fund sector, particularly amongst smaller and medium-sized pension funds (see Clark and Monk, 2017). Note, this may not resolve the pension fund governance 'problem' so much as clarify the roles and responsibilities of board members and staff as well as the expertise board members require to be expert not just competent decision-makers.

In a recent paper published by the regulator, concerns were expressed about the effectiveness of the conventional model of UK pension fund governance and various options were canvassed including the sole trustee model of governance (The Pensions Regulator, 2019). In a follow-up paper, the regulator covered three topics. On trustee knowledge and understanding, the regulator indicated that it would review the content of the toolkit for relevance and depth. On scheme governance, it indicated an interest in providing 'practical support' and encouraging research on the issues. And on fund consolidation, it would work to encourage this process (The Pensions Regulator, 2020a).

The implication to be drawn from this discussion of the challenges posed by disruption in technology and in the stability and performance of financial markets is that competence and conventional ways of making decisions often leave UK pension funds as spectators rather than participants in financial markets and the technological revolution (Monk and Rook, 2020).[12] In this respect, TPR is presumably aware of the gathering forces of change in the industry. However, the regulator's focus on facilitating adaptation rather than promoting innovative models of governance and decision-making in the face of disruption implies that incrementalism could adversely affect the sector and the welfare of its participants.

Conclusions

In many respects, the governance and management of UK pension funds is an everyday event sustained by accepted codes of practice. Whereas its roots in English common law are visible in pension fund decision-making, so too are TPR's codes of practice. In effect, UK pension fund governance is the product of long-term accretion – the sum of separate codes of practice that have been instituted to solve problems identified in standout cases of poor governance and mis-management relevant to the sector.

The UK pensions regulator has created a system of pension fund oversight that is an extension of a British reluctance to use codified rules and regulations to ensure compliance with statute (as in the United States). But it is a comprehensive code of practice which is, in effect, compulsory. As such, informality and the presumption in favour of the discretion of private actors – hallmarks of what Moran (2003) identified as characteristics of an earlier era of UK regulation – have been replaced by systematic intervention into the principles and practices of pension fund governance. In this respect, the pension fund regulator exercises control of pension fund governance through soft regulation not hard regulation.

The genesis of the current regime of UK pension regulation can be traced back to standout cases of failure. While the Mirror case and the Mineworkers case are now footnotes in academic papers that chart the evolution of UK pension legislation, these cases have cast a long shadow over the integrity of UK pension fund governance informing, in particular, the logic underpinning UK pension policy over the past 25 years. It is arguable that strengthening the powers of TPR in relation to the principles and practices of UK pension fund governance is representative of a remarkable period of government innovation and intervention in the British pension system (witness, for example, the establishment of the NEST).

As well, TPR has carried forward the common-law doctrine of fiduciary duty. At one level, it could be argued that this has been a gesture of continuity rather than a commitment in substance to the doctrine. The regulator has maintained the relevance of the doctrine even if it is conditional on pensions policy and practices rather than absolute. In many respects, fiduciary duty provides those responsible for the well-being of others the authority to make decisions on their behalf and considerable discretion as to how best to do so. In theory, authority combined with discretion allows trustees to make decisions tailor-made to the circumstances of those who would directly benefit from their actions. This is evident, for example, in the framing and implementation of investment strategy. But this is theory rather than practice.

The regulator's codes of practice provide administrators and trustees with a manual for the governance and management of UK pension funds. In doing so, the regulator has been concerned to 'level-up' the quality of UK pension fund governance rather than lead the sector in terms of innovative ways of managing pension funds in changing circumstances. There can be no doubt as to the importance of improving the quality of pension fund governance; for many years, these organizations lived in the shadows of the public and private sectors, attracting attention only in extreme circumstances when the best interests of pension plan participants were already lost.

Fundamentally, the process of framing and establishing the codes of practice has been one-sided – separately and together they encourage convergence on convention rather than innovation. Furthermore, it is arguable that they exist to improve the governance of the average UK pension fund rather than reward innovation in the sector. Indeed, in substance, the codes of practice do not provide a roadmap for the best practice DB and/or DC occupational pension funds of the next generation. As such, it is a mode of regulation which seeks to protect the interests of the government of the day, TPR and the PPF rather than employees of tomorrow.

It was suggested that the codes of practice are best suited to an economic and financial world wherein circumstances are benign or at least not systemically threatening. Moreover, TPR has been concerned with the average plan, and individual plans that are recognized as being close to failure. Over time, the government of the day and the regulator have hoped that, by improving the average level of pension fund governance, this may discount the likelihood of instances of pension fund failure and the political costs attending to these cases. In which case, the current regulatory regime is an exercise of risk management which favours the interests of government and the regulator rather than the average pension fund participant.

Larger challenges have been missed including the revolution in information technology and recurrent economic and financial crises. It is entirely reasonable to suggest that modest levels of pension fund governance mean that the average pension fund is very much at risk to the costs and consequences of these forces of disruption. It would not be surprising if the government and the regulator responded to this criticism by arguing that improving governance is a precondition for adequately responding to these circumstances. However, it is argued in this paper that the governance regime itself may be ill-equipped to deal with the challenges posed by disruption. That is, the model of governance embedded in the regulator's codes of practice is out-dated and is a barrier to innovation.

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ORCID iD

Gordon L. Clark https://orcid.org/0000-0003-3159-7674

Notes

1. The intimate link between rituals and their performance is arguably necessary in the sense that agency (action) is a necessary ingredient in reproducing codes of practice time and again. Dacin et al. (2010) suggest that this type of 'public' display is distinctively British and is found in a variety of organizations some of which are at the heart of government and governance.

2. More generally, Haldane (2014) reported that the value of assets under management held by insurance companies, pensions funds and related intermediaries was approximately 45% of gross domestic product (GDP) in 1980 and was approximately 215% of GDP in 2013.
3. The investigation into the collapse of the Maxwell empire also informed the Report of the Pension Law Review Committee (Goode Committee, 1993), the White Paper on Pension Security (House of Commons, 1995), the policies of the (then) pensions regulator (Occupational Pensions Regulatory Authority) and the substance of the Pensions Bill (87, 1994/95). Myners Report (2001) also referenced the debacle.
4. In his discussion of UK pension reform since 1946, Disney (2016) showed that participation in employer-provided private pensions peaked in the early 1970s with about 8 million participants and had halved by 2013 notwithstanding a near-doubling of private sector employment over those 40 years.
5. Government has encouraged the creation of private sector companies whose purpose it is to acquire private DB pension assets and liabilities, in effect severing the link between plan sponsors and DB obligations in pooled investment vehicles. The market for DB scheme consolidation is small but growing.
6. The pension regulator's policies and procedures for granting equivalence are cumbersome and opaque. As a result, obtaining an exemption from a code or set of codes is difficult and time-consuming. In other types of regulatory regimes, exemptions are commonplace especially if the 'purpose' of regulation is achieved albeit by different policies and procedures that reflect 'local' circumstances (Greenwalt, 2016).
7. The *Cowen* case is interpreted in a variety of ways, often focusing upon the powers of trustees to invest in environmental and social causes. See the Freshfields Report (2015).
8. Groups like boards work best when members have a shared project, have similar motivations and can put aside their differences in favour of that which unites deliberation (Krueger et al., 2006). Effective groups tend to converge on information that allows for the resolution of contentious issues rather than reinforcing differences (Mojzisch and Schulz-Hardt, 2006). As such, board coherence is less about 'who' board members are than their willingness to engage in deliberation on matters of substance. See also Pye (2013) on related research focusing upon UK corporate boards of directors.
9. The costs and consequences of board 'overload' and being 'busy' rather than strategic are difficult to quantify. There is little research on this topic other than Kaczmarek et al.'s (2012) research on the performance of UK corporate boards of directors. They show that being 'busy' has tended to reinforce the adverse effects of shortcomings in board structure and performance as regards corporate value.
10. In some OECD countries, pension entitlements along with home ownership have come to represent important sources of middle-class wealth (Chwieroth and Walker, 2019). As a result, governments have sought to dampen downside financial volatility especially as it affects DC pension plan participants' account balances.
11. Nichols (2017) suggested that experts translate knowledge and understanding of an area into decisions that make a difference time and again. He observed that experts are self-conscious about what they know and don't know and how changing circumstances may prompt adjustment of, and/or re-calibration of, decision-rules. That is, experts are aware of the dangers of confirmation bias.
12. Here, I dispute the claim that generalists willing and able to focus on the welfare of beneficiaries are just as good as experts (see Epstein, 2019). Experience and a willingness to learn is not enough when dealing with decision-environments subject to exogenous shocks and non-recursive market responses (Weitzman, 2007).

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