Summary
- Recent disasters mean the industry has been criticised for having a closed mindset and failing to learn from its mistakes.
- An open-loop approach has been advocated in a report by the Pensions Institute and Cass Business School, which offers a damning review of the industry, accusing it of playing a 'blame game' when things go wrong.
- The extent to which lessons are learnt from mistakes is debatable, but it is unanimous that more can be done to make the most of these lessons.
- Ideas around changing the culture of the industry include a standing pensions committee, harnessing the open-loop approach around environmental, social and governance practices and pre-mortem exercises.

The defined benefit sector has faced mounting issues over the past few years, but has it done enough to stop the blame game and learn from its mistakes? Theo Andrew investigates

Mistakes must be celebrated. Perhaps not in the literal sense, but they can certainly be seen as an opportunity. An opportunity to learn, as the uber successful will tell you, should never be passed up, so why is the defined benefit pensions sector so bad at it?

While it may not be revolutionary to say, but might well be impossible for some to admit, the pensions industry can sometimes suffer from a closed mindset. Perhaps this is through no fault of its own; as a complex business it can often be at the mercy of many conflicting factors, and it is hard for anyone managing a pension scheme to predict what is going to happen at any given time.

Former Pension Protection Fund chief executive Alan Rubenstein hinted recently, with an air of inevitability, that the pensions lifeboat will see £12 billion of claims between now and 2030, saying "you would expect more cases like Carillion in any scenario". But the onus must be on how we can stop this happening for good.

The Department for Work and Pensions DB White Paper, *Protecting Defined Benefit Pension Schemes*,

published in March, identified some important points to increase transparency and accountability in order to stop this scenario, but for many it lacked a bite.

In February, the Pensions Institute and Cass Business School released a joint report, *Bringing Black Box Thinking to the Pensions Industry*. The report is an attempt to understand the strategic decision making of the UK's 6,000 DB pension schemes and advocates an 'open-loop' approach to learning from mistakes.

In a damning review of the DB sector, the report said: "Less fortunate schemes exhibit typical behaviour of a closed-loop mindset, including not setting strong measurable targets, inertia in decision making, herding behavior shifting goal post failing to take ownership of mistakes and blaming others" – sentiments that could arguably be used to describe many others across the industry.

Failing to learn

While the industry is on a constant journey to improve, it is still surprising that more hasn't been learnt from headline cases.

Of course each case is different. Whether it's a BHS implementing an overly-aggressive investment strategy, or a Carillion dishing out a generous dividend policy, each gives the industry scope for improvement.

JLT Employee Benefits director Charles Cowling says: "There isn't a complete failure to learn … but I still think we haven't learnt enough. We haven't looked through a Carillion-type situation to see what should have been done at a much earlier stage to make sure this didn't happen."

This is an attitude that BESTrustees chairman Alan Pickering also believes to be true.

He says: "Too much of the pension legislation and regulatory rules are a direct response to individual blemishes without giving sufficient time to think through these blemishes, and the result is a set of circumstances that are unlikely to occur in exactly the way it hit us last time round."

While Pickering is all for learning from the lessons of the past, he believes that it has to be the right lessons, and not "by means of a knee-jerk reaction that forces politicians to take steps in a hurry", creating "too many loops in the legislative chain".

On the other side of the fence, Lombard Odier Investment Managers head of pensions and insurance solutions Ritesh Bamania believes that actions speak louder than words, and that there has been a great improvement in the quality of advice given over the past few years.

He comments: "I have been a consultant over the past few years, moving to fund management last year, and the kind of advice given to clients has been improving. The questions we are asked are becoming increasingly technical and this is requiring increased transparency, which is great."

Bamania picks up on an interesting point. Transparency is fundamental when trying to learn from mistakes. However, when things do go wrong with pension schemes, the industry has an incredible knack of attributing the blame elsewhere.

Pointing the finger

Dissect the aftermath of Carillon and you begin to see something a bit more troubling at work; a distinct lack of accountability.

There was a tremendous back and forth between trustees, finance directors, chief executives, advisers and even the regulator, who all laid the blame at somebody else's door and played it all out in the public eye. Society of Pensions Professionals president Hugh Nolan feels that trustees are at times at the mercy of their advisers.

He says: "Having sat on both the adviser's and trustee's side of the fence, I'm aware there are quite often concerns that advisers are the true power behind running schemes and that trustees are not able to challenge that particularly well. An adviser who has made a mistake will blind the trustees with science … rather than saying hands up we got this wrong."

This, Cowling says, rings particularly true when considering the investment principles of schemes: "Ultimately pension schemes need to be better funded and less risky. The lessons from all that have gone wrong is that they have invested too riskily, and they didn't have enough money."

One of the challenges that arises from this, Cowling believes, is conflict of interest and self-interest.

"The asset management industry is not going to say, don't invest in all our wonderful equity products, when the reality is the case for equity is low, so why are such risks being taken?"

Bamania elaborates on this point and emphasises that it is simply impossible to be an expert in all areas. Whether you're a consultant, fund manager, or trustee, collaboration is key.

"It is through people working together and communicating, whereby we will help identify what can, and what did, go wrong. All the aspects need to come together … and using complementary skillsets that combine positively is essential."

Opening the loop

An area that some feel can pave the way and really harness the essence of open-loop thinking, and to an extent is already actively sharing data sets in search of better solutions, is environmental, social and governance (ESG) investment considerations.

Cardano senior client manager Helen Prior believes it is the sharing of information on ESG that really sets it apart from other investment-related topics, and that makes it particularly useful when practicing an open-loop approach.

She says: "We have seen some progress already because it is an open loop. In the past ESG was synonymous with taking an ethical stance and somewhat divorced from financial returns. More recently we've seen that ESG factors are indicators of long-term stability and part of prudent risk management, which trustees should logically want to engage with."

Investing with an ESG mantra requires the sharing of data like never before, which allows you to create a holistic approach to investing, and ultimately greater ownership over impact management and risk analysis.

An aspect of ESG that could help break the groupthink is diversification of the trustee board.

According to the Institute and Faculty of Actuaries (IFoA), 77 per cent of board level and 86 per cent of executive committees were held by men in 2017, but there are efforts in place to help change this.

Last year the PLSA, with the support of the regulator, launched the *Breaking the Mirror Image* campaign, encouraging greater diversity on trustee boards by "putting diversity at the top of the agenda".

"You talk about groupthink and consensus and that's where diversity might help you, when everybody comes in from a finance background saying we know our numbers you don't get the same breath of judgement. The more diverse your trustee group is the better", Nolan says.

Despite being one of the more innovative ways to encourage open-loop thinking, this solution again places the onus of trustees. However, another solution is the idea of a standing pensions commission.

Such a body would build up a store of experience, a dedicated pensions corporate memory, which would allow the industry to learn, instead of setting up "adhoc review committees" and relying on the "media-greedy tendencies of politicians in public", Pickering says.

"I can't think of anywhere better to store the corporate memory so that the regulator's virtual library and actual experience can help protect politicians from the 'somebody must do something about it' syndrome."

Pickering suggests this would hit the open-loop nail on the head, getting to the crux of the problem of not learning from mistakes by creating a commission that bypasses the government nature of discarding expertise once legislation has gone through.

Cardano director Stefan Lundbergh agrees: "A standing pension commission is a great idea. I would go even further and say they should look at problems and try to come up with and analyse what is the common theme.

"As soon as a pension fund above a certain size enters the PPF, there must be an investigation like when an airplane has crashed, to ask what went wrong? How did it end up here? To find out what we can learn and then share it, without pointing a finger."

In 2015 the PLSA called on the government to implement an independent retirement savings commission, a non-legislative body to make recommendations on the direction of future policy, to "create greater stability and certainty around the big issues on the horizon for pensions". However since then calls for a commission have been muted.

With the idea of a standing pensions committee some way in the distance, Lundburgh suggests a more simple tool that trustees can use now to avoid falling into a groupthink scenario.

"Pre-mortem is the easiest, just to say, 'five years from now we have to hand in our keys to the pension protection fund and what event, given our current strategy, what could have caused us to end up in this situation?'.

"That forces you away from your standard thinking; you need to find the things that could have killed you, play devil's advocate to break the groupthink."

The PLSA advocates this approach. Its head of governance and investment Joe Dabrowski says that if airline-style black box thinking were to be implemented in the pensions industry, a focus on building the right culture, with the right people and resources to support would be needed, as laid out in in its *Good Governance – how to get there paper*.

So, do we accept it as inevitable the PPF's predictions that up to £12 billion of members' defined benefit money will fall into the lifeboat over the next 12 years, or do we open the loop and learn, properly, from the mistakes industry has made now? I know which one I think we should be aiming for.

Written by Theo Andrew