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Review

Board of trustee's composition as a determinant for adopting risk management by pension schemes

Jonah K. Aiyabei[1], Patrick K. Karanja[2], and Paul Katuse[3]

[1]Phd Student Jomo Kenyatta University of Agriculture and Technology, Kenya
[2]Lecturer Jomo Kenyatta University of Agriculture and Technology, Kenya
[3]Professor of Strategic Management United States International University, Kenya

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This study constitutes a review of literature on the influence of board composition on adoption of risk management. The study examines three key categories of board composition namely; Board of trustees diversity, Board size, Board and Board of trustees Qualifications. The study identified trend on literature is that the composition of trustees plays a significant role on adoption of risk management and recommends empirical studies in developing economies to test if the trend hold true.

Key words: Risk management, trustee's composition and pension schemes

INTRODUCTION

Recent studies point to Board oversight as a top driver of a company's attention to sustainability. The ability of a Board to effectively oversee corporate sustainability depends to a large extension its composition. It is important who the Directors are and how they organize to fulfill their duties. According to the UN Global Compact Accenture CEO study (UN – GCA) an increasing number of companies are starting to realize the important role a Board must play and that 75 percent of CEO's report that their Board takes an active role in considering and acting on sustainability issues. In overseeing risk management, Boards should as part of an integrated approach ensure that the company considers the full spectrum of risk factors related to, for example, possible human rights violations and corruption. It should require management to factor in the potential impact these types of risks can have on the company's reputation and brand value, as well as more direct consequences on operational costs and market behaviour.

Walt and Ingley (2008) defines board composition as the concept of diversity relating to the varied board of trustees combination of attributes, characteristics and expertise contributed by individual board members in relation to board process and decision making. Rose (2005) argues that there is no commonly agreed upon definition of what board composition covers. Board composition can be defined in many different ways, yet most common is the discussion of scheme outsider and scheme insider representation on board reflecting the issue of board independence (Hoyt, 2012). According to Law debenture report (LDR) how trustees manage risk is a cornerstone of good governance; it is about anattitude of mind and a way of thinking and acting (LDR, 2008). The most effective and sustainable approach to dealing with risk is one which is practical, which becomes integrated with routine activity and which is seen to result in useful and worthwhile improvements in the way a scheme is run (LDR, 2008).The primary functions of the supervisory board are advising and controlling, or monitoring and thus the corporate governance framework should ensure the strategic guidance of a scheme to meet this and the trustees accountability to the company and the shareholders (Stewart, 2010). The question of optimal board structure is in so far that it is able to fulfill its roles efficiently and effectively remains unanswered.

The Kenyan Retirement Benefits Act of 1997, provides that the duties of the trustees shall include: Administering the scheme in accordance with the provisions of the Retirement Benefits Act, and scheme rules; keeping all proper books and records of account in respect to income, expenditure, liabilities and assets of the scheme fund; computing and preparing statements of payments of benefits to members; liaising with the

Authority, sponsors, members, manager, custodian and any other professional engaged by the scheme; collecting, keeping and updating retirement benefits data of each member including maintenance of individual membership records and bank account details of the members for the purpose of payment of benefits; updating the sponsor at least quarterly during the financial year on all matter regarding the scheme (KRBA, 2011). In this paper we review literature on the composition of the Board and influence on adoption of risk management.

Composition of board of trustees

Composition of the Board of trustees is addressed based on the Trustees Diversity, Board of trustees' size and qualification of trustees.

Board of trustees' diversity

Boards are often criticized for being comprised of too many members with similar backgrounds, education and networks. Diversity favours the exchange of ideas and ensures that multiple perspectives are represented when the Board engages in strategic discussions and makes long- term business decisions. Studies () shows that there exist positive correlation between Board diversity, strategic innovation and corporate reputation. To be at its best, a Board requires a diversity of skills, cultures, ethnicity, age and viewpoints. Especially for companies with a multi-regional market reach, or vital operations or suppliers in anon-domestic environment, representation of Directors with experience from relevant countries and regions may be of particular importance. Diversity acts as an end in itself – sending positive signals to internal and external stakeholders – and appears also to be a means for improving the ability of the Board to oversee corporate sustainability

The OECD principles on corporate entities provides that at least half of the board's members need to be independent, which in essence means no close or personal ties to the company, and it should be of appropriate size in relation to the organization's complexity while ensuring a certain degree of diversity among the board members regarding their backgrounds, areas of expertise, and experience among many others (Stewart, 2010). Carver (2002) argues that a stakeholder's oriented approach uses boards of trustees in their stewardship role due to moral obligations as a justification for board diversity. Gregoric, Oxelheim, Randoy and Thomsen (2009) in their study of Nordic firms between 2001-2007 find that diversity along the measures of gender, qualification of trustees, nationality and age dispersion has a positive impact on firm performance and risk management strategies with respect to firm value return on assets, risk management and growth.

Britain's Cadbury Report (1992) calls on boards to take responsibility for the governance of their firms and should at least have three independent directors in the Board (Cardbury Report, 1992). Canada's Dey Report (CDR) recommends that boards need to explicitly assume responsibility for governance, including, leadership, stewardship, risk management and information (CDR, 1994). The US Sarbanes-Oxley (2007) Report by US exchanges (US-SOR) mandated board audit committees to constitute Boards to consist primarily independent (outside) directors (US-SOR, 2007).

Sponsor and members' nominated trustees

Sponsor's and member trustees ratio in a board of trustees are prescribed by the Kenyan Retirement Benefit Act (KRBA) provides that for a DB scheme, the number of member elected trustees should be at lead one third of the total trustee (KRBA, 2011). For a defined contribution scheme the Act provides that 50% of trustees to be nominated by members. Members often elect from the active members (those in employments) or from the pensioners. The Sponsor's two –third trustee can be drawn from employees or independent appointed. Cocco and Volpin (2007) find that insider trustees (those that are also a part of the management of the company) tend to act in the interest of the plan sponsors, not necessarily in the interest of plan members. Kakabadse and Kakabadse (2005) argues that lay trustees display similar characteristics in as professional trustees and are capable of handling pension plan decisions.

Gordon and Roe (2004) see the embodiment of worker-elected representatives on a board as an important part of corporate governance. Bhagat and Black (2008) counter this argument through their finding that the ratio of outside directors on board is unrelated or even negatively correlated with firm value, measured by Tobin's q in their respective studies. Rosenstein and Wyatt (1997) as well as Klein (1998) argue that insiders can provide relevant inside information and demonstrate commitment and conclude that insider representation on board appears to increase firm value. Bhorjraj and Sengupta (2010) document those firms with strong outside directors (independent directors) lower firm risk. On the Board composition, evidence on the relation between board composition and risk management adoption are mixed. The importance or board independence is rooted in the separation of ownership and control (the agency issue), which arises due to dispersed ownership that lacks strength compared to the management of the firm (Hoyt, 2012). The presence of outside directors or trustees is directly linked to discrete tasks, including the hiring and firing of the Chief Executive Officer (Weisbach, 1988)

Gender mix of the board of trustees

Gender the Kenyan constitution 2010 (RoK, 2010) provides that each public office should have at least one-third of the members from either gender. It follows therefore that the trustee's composition for public service occupational pension schemes will be readjusted to comply with the constitution. Generally speaking, the presence of women in corporate board rooms remains relatively weak (Daily, 2009). The potential benefits of female board presence in relation to firm performance have been at the core of the debate and academic research and independent studies have yielded mixed results (Muhammad, 2011). Gordon and Roe (2004) offer insights on how employee representation affects firm decision making and financial performance. Their study is one of a few quantitative studies in this area. Rose (2007) concludes from his theoretical work the hypothesis that a higher degree of women represented in corporate boards impacts risk management and financial performance positively. His empirical work fails to find a significant link between female board representation and firm performance as measured by Tobin's q (Rose, 2005).

Age of trustee

The age structure of the trustees has been found to have an influence on the performance and embracing of risk management with younger employee willing to take aggressive options and the older being conservative and diligent on risk management (Kostyuk and Koveraga, 2006).

Board of trustees' size

Board of trustee's size refers to the number of board members that are governing a pension scheme in accordance with the trust of the scheme (Muhammad, 2011). On the size of Board of Trustees, Song and Cummins (2008) argues that larger boards could be less efficient and less effective due to coordination problems arising because of its size and that the smaller boards operate more efficiently. Evidence related to firm value, as measured by Tobin's q, demonstrate that smaller boards are associated with higher firm value and efficient risk management, because smaller groups are more cohesive and hence can fulfill their monitoring role better (Song and Cummins, 2008).

Number of trustees

The Kenyan Retirement Benefits Act of 1997 provides that a trustees Board should have a maximum of nine (9) trustees and a minimum of three trustees (KRBA, 2010). The ranges of six provide room for various sizes of trustee's numbers from one scheme to another. Hoyt and Liebenberg (2009) argue that larger firms are more likely to engage in risk management due to their relatively high complexity, the fact that they face a wider array of risks, and their financial ability to bear the administrative cost of risk management adoption. Pension Management Institute (PMI) developed a model

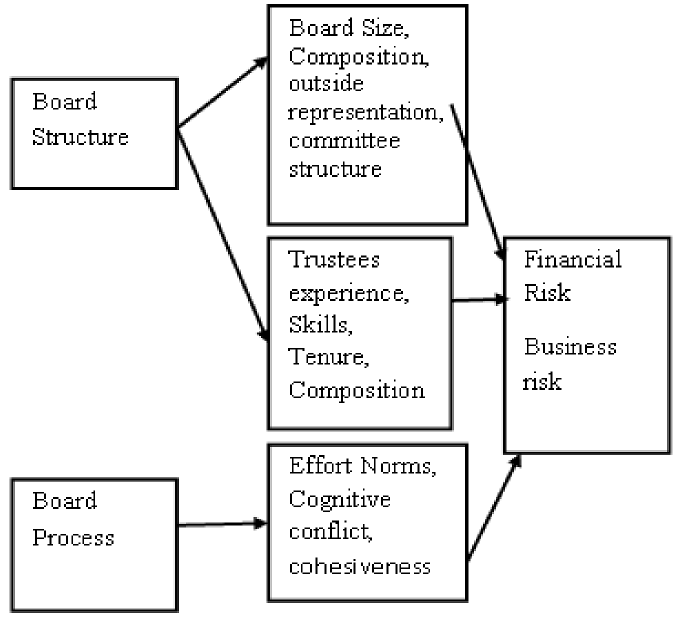

Figure 1: A model of the effect of Board attributes on risk management
Source: Davis (2001)

of the effect of board of composition on risk management, the identified attributes of the board incorporated in the model are (figure 1); Board structure as explained by Board Size, Outside representation, committee structure Trustees' Skills and Board process as represented by effort, norms and Cohesiveness (PMI, 2010).

Qualifications of the trustees

In Kenya under the Retirement Benefits Act, there are no minimum qualifications for one to be a trustee. However, the Act was amended in the year 2010 to requirement pensions scheme to train and certify at least one member of the board on the Trustees training certification course offered by the Retirement Benefits Authority and the Association of Retirement Benefits Schemes (ARBS). It is thus uncommon to find trustees elected by members on the basis of union activism and not on knowledge of pension scheme governance (Kiragu, 2010).

The present study investigates the influence that the Board Composition has on adoption of risk management. From the reviewed literature, this study hypothesis is that that the Board of trustees composition of a pension scheme is positively linked to the adoption of risk management by pension schemes.

CONCLUSION

This paper reviews literature on studies inclined to investigates the influence that the Board composition has on adoption of risk management. From the reviewed literature, this study hypothesis is that that the Board of trustees composition of a pension scheme is positively linked to the adoption of risk management by pension schemes. A comprehensive study need to be studied particularly in developing countries to test the influence of board composition.

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