



THE SOCIETY OF PENSION
PROFESSIONALS

making pensions work

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5 September 2023

Dear Department for Work and Pensions

SPP Response to DWP & HMT Call for Evidence on Pension trustee skills, capability, and culture.

Detailed Response

Chapter 1: Trustee skills and capability

Question 1: Do trustees know what the knowledge and understanding standards expected of them are?

We would expect that the majority of trustees, even of the smallest schemes, will be aware of the TKU standards expected of them. However, that is not to say that the expected standards will be met and maintained. There is clearly considerable divergence in the qualities and experience of trustees – the rule of thumb being that smaller, less complex schemes will have less competent and experienced trustees than larger, more complex schemes, based on the premise that there will be (i) a smaller budget, for both training and for professional third party input, (ii) less time required to be spent practising and developing those skills, and (iii) less financial risk and therefore less oversight and involvement from scheme sponsors.

We expect that most DC schemes would fall into the “simple” definition and most DB schemes would fall into the complex category, although commercial DC schemes, such as master trusts, and schemes which offer in-scheme drawdown, would also fall into the more complex category.

In theory, at least, the Chair's Statement requirements, as they stand today, should include a narrative about how trustees have gained and maintained competence. In practice, it seems likely that some of this narrative – for some schemes – may be open to challenge. There is no requirement to substantiate the claims or provide proof points unless there is intervention from the Pensions Regulator.

We expect that awareness of the required standards is likely to be at its highest point on appointment. Thereafter, without formal training or periodic “MOTs”, it is likely that this

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awareness will wane over time. A more detailed assessment of individual and board competence, accompanied by the availability of relevant proof points, should ensure that standards are maintained.

Advisers can fulfil an important role, of course, such as filling knowledge gaps, identifying extant or potential issues, raising awareness of new regulation, legislation, market trends and opportunities. It is nevertheless highly important that trustees are equipped to know what they do not know so that the advisory budget can be spent cost-efficiently. It is also vital that trustees are equipped to challenge their advisers and capable of discussing knowledgeably when and how to implement change. In short, trustees should not be overly reliant on external advice – they should be capable of independent action from a position of knowledge, whether present or acquired specifically.

We would make the observation that board agendas that include formal, regular consideration of TKU are in the minority.

Question 2: Do trustees currently meet the knowledge and understanding Requirements expected of them? Are some types of trustee better than others?

As noted in our response to Question 1, the extent to which the required standards are met is variable, and there is, therefore, not a simple yes or no answer to this question. Professional trustees are, of course, expected to meet the requirements to a greater extent than, for example, MNTs, and are expected to perform the role “better”. However, an obvious point to make is that the standards of professional trustees vary considerably – as do the standards of the professional organisations through whom they are commonly appointed.

Some organisations thoroughly check and periodically review competence, including their DEI awareness and composition, and provide regular training, CPD and other support, whilst others do very little in this space. Equally (and inevitably), some trustees within those organisations have more experience, technical knowledge and soft skills than others. Therefore it is too simplistic to equate professional with better – a structured evaluation of the organisation (where applicable) and individual is necessary, taking into account the sponsors' objectives.

The evaluation of a professional trustee organisation is even more important in a sole trustee model. Whilst technical expertise is relatively assured, there are potential risks around diversity and freedom to act in an environment where house views may become culturally embedded. Despite the fact that the Code of Practice for Professional Sole Trustees of Pension Schemes requires that “Diversity and inclusion should be considered by the PCST firm during their decision-making”, we consider that more guidance as to how this can be achieved (and demonstrated) may be necessary (such as in relation to how should firms identify (and address) intermittent gaps in their skill-sets).

Similarly, the quality of company-appointed trustees and MNTs will vary significantly. However, it is important to note that such appointments are usually made with diversity in mind (and therefore for a specific and narrower set of objectives) than with professional trustee appointments. For example, an MNT who focusses on engagement and “voice of the member” issues. Consequently, such trustees can and should be expected to have a narrower set of overall skills, but their input can nevertheless be highly valuable to the board as a whole. To ensure that the principles and objectives of diversity are not diluted, focus should therefore be on the skills of the board as a whole and (critically) the reliability and efficacy of the evaluation process that

measures it.

There is also a natural element of self-interest within the professional trustee sector which may be at odds with the objectives of the sponsor (or, in the opposite case, unduly supportive of the sponsor's objectives in order to retain an appointment). An obvious example of the former would be where an employer wishes to wind up/consolidate a scheme, but the professional trustee does not prioritise that objective. In circumstances such as these, it is arguable that the professional trustee is not performing "better" – even if members' benefits remain well protected and outcomes are good. Sponsors and trustees should set short, medium, and (if necessary) long-term objectives which the board can then work towards and be measured against – otherwise, the concept of "better" is intangible. (This introduces the concept of "tactical trusteeship" which we explore further later). This is critical as a sponsor's desire to consolidate, for example, may not be reflected in the trustees' objectives and actions.

Question 3: What are the barriers to improving trustee capability? What do you think government should do to ensure that all trustees meet the standards expected of them? Does trustee liability put off potential trustees?

There is little standardisation of the capabilities required for trustees generally, although accreditation is a move in the right direction for professional trustees in particular. Soft skills are vital for good outcomes, but currently, there is no reliable scale or benchmark against which they can be measured.

Keeping in mind the comments in the answer to Question 2 above (about employer nominated and MNTs generally adding diversity but having a narrower range of objectives), there is no reliable standardisation at the individual level either. The absence of clarity over what is required is a significant barrier.

Other barriers include:

- (i) the budget (and time) available for training and/or advice (which is impacted significantly by frequent regulatory and legislative change – see also below);
- (ii) awareness of (and therefore support from) the sponsor of the necessity for good trustees who perform their role by reference to appropriate objectives;
- (iii) the relatively narrow pool of professional trustees, the majority of whom have more DB than DC experience;
- (iv) constant regulatory and policy change, keeping on top of which demands both time and money (e.g. investment complexity, VFM assessments, etc); and
- (v) the assumption that all trustees need to meet the same standards, which ignores the reality of the fact that some trustees are appointed for particular knowledge and skills (diversity).

In terms of what can be done to improve standards, we would recommend that more focus is given to encouraging and improving board effectiveness evaluations rather than individual trustee standardisation, which is neither desirable (see below) nor achievable under current legislation (e.g. MNT requirements). Board agendas should include regular effectiveness evaluations and training and competence programmes, and there should be greater rigour and consistency over how such evaluations are undertaken and reported. Such evaluations should reflect, as noted elsewhere, the sponsor's short, medium and (if appropriate) longer-term objectives to ensure that

the appropriate skill-set exists to achieve them. This builds on the concept of “tactical trusteeship” referenced above – subject-matter expert trustees, with executive powers (in contrast to advisers) who can help deliver those objectives. An obvious example would be consolidation expertise.

It is possible that the trustee toolkit can be evolved in a modular manner so that trustees who are brought in to fulfil a specific role can be measured against those specific standards rather than more generalised skills as under the current approach.

We do not believe that the liability risk is a significant deterrent, although, clearly, some schemes will pose higher risks than others, and this may therefore discourage participation. Employer indemnities and/or insurance are available, although we recommend formal regulatory engagement with indemnity underwriters so that premiums reflect actual underwriting risks rather than perceived risks.

Question 4: Do trustees (including Master Trust trustees) have the right knowledge and understanding to invest in the full breadth of investment opportunities? If not, what can be done to improve this?

Trustees today are more heavily reliant on advisers in the ever-evolving investment space than hitherto.

Effective boards should have the right mix of skills to understand, from a high level, risks, opportunities, compulsion and soft compulsion (by which we mean comply or explain scenarios) sufficient to challenge advisers, but clearly, some will be more competent than others. The ability to challenge advisers is a core board skill that should be a key part of the evaluation process.

As the regulatory direction moves away from simpler, liquid pooled funds, it is worth noting that many advisory firms themselves will need to upskill and maintain competence in this field. This will likely increase fees and add pressure to the advisory budget.

Notwithstanding the above, some trustee boards should need to do little more than discount investment in some asset classes. In particular, where the trustees expect to complete a scheme wind-up/buy out in the short-term (or even medium-term in some cases), it is unlikely that investment in illiquid assets would be appropriate. Moreover, in such a scenario, the trustees will be mindful of aligning their investment strategy with that of the potential insurer.

In addition, some investment strategies are unlikely to be viable for smaller schemes due to their lack of scale. We appreciate this supports the argument for greater consolidation, although perhaps more could be done to encourage the development of platforms that can make access to productive assets (including patient capital) easier for smaller schemes. In particular, we note the development of Long Term Asset Funds, which should assist in this regard.

We also note that regulation and supervisory activity in recent years has urged a focus on ESG matters in general and climate-related risks and opportunities in particular. For some trustee boards, this has perhaps been at the expense of being able to devote time and resources to upskilling in other areas – such as patient capital.

Question 5: Is there enough understanding of advice around the consolidation of schemes?

No – although there is significant knowledge, understanding and experience amongst third party service providers, reliance on specialist support may be a prohibitive cost barrier to consolidation for some schemes. Our earlier comments about tactical trustees appointed for a specific remit are particularly relevant to this scenario.

Question 6: Do you think that the government should require all trustees to provide information to enable TPR to keep a register of all trustees?

Yes – but we believe that the contents of the register should be consulted on, and we are mindful of data minimisation principles underlying the UK's data protection legislation. For example, where trustees are appointed for a specific skill-set, this should be reflected in the information on the register. Clearly, the information required for professional trustees should be more comprehensive (and justifiably intrusive) than for non-professional trustees. This is especially so for sole trustee appointments where assurance is needed around thought diversity in addition to technical competence. The approach adopted in the Isle of Man could provide government with a reference point for how to regulate this area. If a register were to be introduced, perhaps the registration requirements could be phased in, starting with (for instance) schemes with more than 500 members.

Question 7: If the government were to require this information, would it be best achieved through the scheme return or through a separate trustee return?

Logically, to avoid duplication, this should be through the Scheme Return or Exchange. However, there is also a logic in requiring a separate return for professional trustees. This could be a standardised return that all individual practitioners and professional trustee organisations (rather than schemes) could be required to complete – in effect a CV library to help enable schemes to identify the most appropriate persons to appoint and which the Pensions Regulator can also use for fit and proper person assessments. This could include, for example, specialisms, fees and minimum terms of appointment to support tactical appointments.

Question 8: Do current accreditation frameworks provide a high enough bar to equip trustees who become accredited to properly fulfil their role, including in making investment decisions?

These frameworks work satisfactorily at a specific point in time, but may not be reflective of contemporaneous and/or soft skills. In particular, we do not believe that the current accreditation system satisfactorily addresses the complexities of the changing investment landscape. Relevant modular updates would help provide evidence of knowledge maintenance and development.

Accreditation should, in theory, better equip individuals to perform their role – and the presence of accredited trustees on a board should reassure sponsors and members and even play a role in indemnity insurance underwriting. The focus for accreditation should be on professional trustees rather than lay trustees, however, with accreditation being mandatory for all professional trustees (at an individual level, rather than a firm or house level). With this in mind, as noted elsewhere, a case could be made for considering how a board accreditation system might work in addition to individual trustee accreditation.

Question 9: What proportion of your trustee board are accredited trustees?

Other than in commercial schemes such as master trusts, for which the proportion is rightly higher, the proportion is low – commonly restricted to no more than one or two professional trustees on a board. Some boards have no accredited trustees. Scheme size and complexity is the usual determinant of such appointments, given the likely impact on fees.

Question 10: If we required each scheme to have a certain proportion of accredited trustees, where should this bar be set? Should Master Trusts be required to have a greater proportion of accredited trustees than single employer schemes?

Again, scheme size and complexity should be a determinant of the right proportion. Budgetary constraints should be taken into account too. Schemes that intend to consolidate could be given concessions, provided the composite board skills and/or advisory support is capable of achieving that consolidation objective in a reasonable timeframe.

The Chair's role lends itself naturally to compulsory accreditation more than other roles, but there perhaps needs to be a greater focus on soft skills such as challenging advisers and sponsors than there is currently.

Master trusts should have a higher bar set, with a majority of accredited trustees supported by subject matter expert trustees. One key consideration should be how the board interacts with the funder and strategist, such as with respect to whether there is proper challenge and conflict management between member outcomes and security versus commercial objectives. The concept of board accreditation seems most appropriate in this environment and goes beyond the existing fit and proper person assessments which concentrate on the suitability of individuals rather than the effectiveness of the board collectively.

Question 11: Should there be more rigorous requirements for those acting in the capacity of a professional trustee? What sort of requirements/standards should professional trustees be meeting? Should there be mandatory accreditation?

Yes – accreditation should be mandatory (noting earlier comments about the potential role of board accreditation).

Replication of the master trust “fit and proper person” regime, supported by accreditation and a similar significant events regime, should be the minimum standards.

Question 12: How would you define a professional trustee for the purposes of legislating for all professional trustees to be accredited?

The Pensions Regulator’s current definition of, and test for, a professional trustee (in its August 2017 description policy) remains appropriate. It is (in broad terms): “ ... acting as a trustee in the course of the business of being a trustee ... ”.

However, to recognise that trustees may have a specific or dominant area of expertise, we suggest the following amendment to page 2 of the policy:

“Where an individual represents or promotes themselves to the trustees or sponsors of one or more unrelated schemes ... as having expertise in trustee matters ~~generally (rather than just in certain areas)~~, whether in certain areas or generally and whether for remuneration or otherwise, we would normally consider them to be acting in the course of the business of being a trustee.”

Chapter 2: The role of advice

Question 13: What are your observations on the external support trustees are given to make investment decisions, particularly in relation to unlisted equities?

Trustees will usually rely on a single investment consultant for all investment advice, and not all investment consultants will research all asset classes. Private equity vehicles are likely a case in point because defined benefit schemes have been letting their private equity allocations run off, and defined contribution schemes have not been investing in that asset class, so it has not been commercial for all investment consultancy firms to research private equity – they need to find a way to be remunerated for their research.

In addition, while the CMA Order has assisted in this regard, some investment consultancy firms are subject to potential conflicts of interest in that they may have developed their own propositions (such as fiduciary management services or master trust arrangements), which may inherently narrow their thinking in relation to investing in the full breadth of available opportunities.

Individual consultants can also vary in quality, even when a firm has good house ideas, although these house ideas may be a list of revenue-generating opportunities meaning trustees can be suspicious that they are getting a sales pitch rather than suitable and tailored advice.

For these reasons, it might be worth government taking appropriate steps to encourage trustees to consider specialist consultancies for advice on private equity investments.

Question 14: What changes could be made, including to the regulatory environment, to improve trustee support in relation to unlisted equities?

Please see the answer to question 13 above. We also wonder if there is a way of the Pensions Regulator publishing independent data on the performance/volatility of different asset classes of investment that would give trustees more insight from a central, reliable source.

Question 15: To trustees: To what extent do trustees use investment consultants to support decisions around allocations to unlisted equities? Did they subsequently increase? Is there a deficiency of knowledge or expertise by investment consultants of these types of investments?

The regulatory environment is such that trustees are completely reliant on investment advice – they need to take suitable advice to amend their Statement of Investment Principles and to select particular investments. Going against investment advice is very hard for trustees to do – good relationships with an investment consultant will be a discussion on the pros and cons of any advice, with good debate and challenge, followed by the consultant then issuing advice that takes

on board the trustees' views.

In addition, trustees will typically be trained on a particular investment type by their investment consultant, who would then give them the investment advice – this is not particularly conducive to fostering constructive challenge from the trustee board. Trustees should perhaps be encouraged to seek training from third-party consultants who may bring alternative views.

Question 16: What changes could be made to investment management to support pension scheme investment decision-making?

A more collaborative relationship with investment managers might bring in more independent viewpoints. This is difficult for trustees to achieve as investment consultants are often the gatekeepers to investment managers and can discourage direct dialogue between managers and trustees. The CMA Order on fiduciary management may also have made managers more reluctant to engage directly with trustees in case they are then deemed to be providing fiduciary management services.

Question 17: To trustees: How does legal advice impact on your investment decisions? What is an acceptable level of tolerance for investment risk? Is there a culture of 'risk aversion'?

Legal advice generally has a limited impact on investment decisions at a strategic and selection level. At the selection level, legal advice is typically obtained for the purpose of carrying out due diligence on the relevant documents, seeking appropriate modifications with the provider, and determining the position in relation to legal protections. Some trustees do not routinely obtain legal advice on their investment selections, however, and instead rely solely on section 36 advice from their investment consultant. This is potentially an area for legislation to address, as investment consultants cannot give legal advice.

At the strategic level, legal advice typically plays a relatively peripheral role, save occasionally in respect to ESG considerations where advice is required on the law of fiduciary duty. Most pension lawyers take a fairly broad view of fiduciary duty in the context of ESG, but some do not, and there are substantial grey areas on the boundary of financial and non-financial factors where a more scheme-focused approach is typically recommended. It is necessary for government to reconcile (a) any policy encouragement for occupational pension schemes to make allocations to particular types of assets, with (b) the law of fiduciary duty (and trustees' other investment obligations).

In general, tolerance for investment risk is normally considered at fund level by considering how the investment diversifies risk and adds return relative to the other components of the portfolio. Any risk aversion by trustees is probably less about investment risk and more about regret risk or the risk of being an outlier.

Chapter 3: Barriers to trustee effectiveness

Question 18: Is fiduciary duty a well-understood concept? Do current regulations and guidance support trustees to make investment decisions which seek higher returns for members? If not,

what changes would be useful?

The core features of trustees' investment duties have been settled in legislation and common law for some time and are well-known to most trustee boards. Challenges come when market or policy developments create new investment considerations that need to be reconciled with fiduciary duty. The emergence of ESG as a driver of investment decisions and government policy desire for schemes to invest in particular ways are examples of this. With the benefit of advice, most trustee boards are able to take appropriate decisions in these areas, keeping in mind that the law does not necessarily require the pursuit of high returns as the sole objective, but the pursuit of the best realistic return over the appropriate time horizon for the scheme given the need to control for risks.

Question 19: Do trustees currently make investment decisions in the long-term interests of pension savers? If not, what barriers are there to trustees making investment decisions in the long-term interests of savers?

Yes – trustees are effective in making investment decisions in the long-term interests of the members of their scheme. It is again important to note that, for both DB and DC schemes, this necessitates a focus not just on return, but also on risk, liquidity and the functioning of the portfolio as a whole. For DB schemes, this plays into the scheme's overall funding position and journey plan. In DC default strategies, a key consideration is that the investment approach needs to be suitable on average, including for individuals who have not made a positive investment selection. The government's emphasis on performance and value (over simply cost) in the context of DC schemes has been clear, with recognition that consolidation is encouraged for DC schemes (typically smaller own trust arrangements) that are unable to reach suitable conclusions on the necessary assessments.

Question 20: How do trustees balance investment returns, costs and charges, and services when making decisions in the long-term interests of savers?

In the context of DB schemes, once the nature of the asset has been selected at the strategic level (taking into account the need for diversification, quality, liquidity and so on), the balance is largely between achieving an appropriate level of return on the invested capital and securing an investment which carries an acceptable level of risk (including in relation to its legal structure and characteristics).

In DC schemes, the most sophisticated commercial master trusts balance matters of value (informed by costs, charges and services) in an advanced way, often using the skills of experienced in-house investment teams and the services of specialist external investment and legal advisers. Smaller own-trust arrangements tend to invest their assets through platforms accessed via the insurance company provider of their investment arrangement and these are often legacy structures that may be inflexible and difficult to transition out of.

Question 21: Do trustees' fiduciary duties discourage investment in alternative asset classes? If so, please explain with examples.

No – alternative assets typically refer to assets that are not listed equities, investment-grade

corporate bonds and gilts, and this presents trustees with a wide universe of investments to select from. Doing so is a complex task and needs to be done in view of the scheme's particular requirements. Achieving an appropriate balance across an investment portfolio necessarily requires a more limited allocation to certain asset classes, but fiduciary duty is not an impediment to doing so.

Question 22: Is the way in which trustees exercise their fiduciary duties preventing trustees from seeking the best returns for pension savers? If so, what is causing this?

No – please see the answer to Question 19.

Question 23: Do those actors who have most influence on advice to trustees on long-term investment decisions experience any challenges or barriers in provision of their advice on illiquid assets? If so, what would unblock this?

Two barriers which can be encountered are constraints on governance budgets and the taking of advice too late in the process when it can be difficult to exercise the commercial leverage to secure meaningful concessions on terms.

Question 24: Would trustees find it helpful if they received more direction from regulators when assessing their investment decision making? In addition to our work on Value for Money we are also interested in whether the advice for trustees provided by regulators via training and guidance supports our objective to shift the focus from cost to value?

Please see the answer to Question 25 below.

Question 25: Do lay trustees have enough time and support to perform their duties effectively? Do professional trustees? If not, what changes would support this?

The industry is currently dealing with a significant level of reform and potential reform across all facets of pension provision and this is occupying a great deal of trustee and advisory bandwidth. Formulating a coherent policy direction, which is supported by focused and concise regulatory guidance, will give trustees the space and clarity to take the best decisions in relation to their particular schemes, recognising that schemes are long-term arrangements (so any changes will not be immediate) and that the sponsor is a fundamental stakeholder in the running of any DB scheme.

Response ends.

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