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Response from the Pensions Management Institute to DWP call for evidence: ‘Pension trustee skills, capability, and culture’

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Introduction

PMI is the professional body which supports and develops those who work in the pensions industry. PMI offers a range of qualifications designed to meet the requirements of those who manage workplace pension schemes or who provide professional services to them. Our members (currently some 7,000) include pensions managers, lawyers, actuaries, consultants, administrators and others. Their experience is therefore wide ranging and has contributed to the thinking expressed in this response. Due to the wide range of professional disciplines represented, our members represent a cross-section of the pensions industry as a whole.

PMI is focused on supporting its members to enable them to perform their jobs to the highest professional standards, and thereby benefit members of retirement benefit arrangements for which they are responsible.

We trust that the feedback in the following pages proves helpful.

Chapter 1: Trustee skills and capability

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

Trustees demonstrate widely-ranging levels of understanding of their role. PMI's Trustee Group contains many boards where all members display a very thorough understanding of what is required of them and who have extensive access to professional advice and other forms of support. However, we are aware of a significant hinterland of trustees with little or no appreciation of what is expected of them and only a rudimentary understanding of their role.

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

Again, the range is significant. Whilst professional trustees and many lay trustees demonstrate a thorough understanding of the TKU requirements, there are far too many who fail to meet even the most basic TKU requirements as defined in PA 2004. Far too many trustees lack the technical understanding and confidence required to challenge the advice given to them by their advisers. This was all too obvious in the wake of the Liability Driven Investment (LDI) crisis during the Autumn of 2022.

As is to be expected, professional trustees - particularly those with formal accreditation - bring a level of competence to the role which ensures that they discharge their duties appropriately. There are also many experienced lay trustees who perform their role admirably. These are inevitable trustees who receive extensive support from the scheme sponsor in terms of providing access to qualifications, ongoing trustee education in the form of conferences and seminars and sufficient time away from their everyday role to maintain and develop their skills as trustees. Those who fail to meet the required standard almost inevitably are poorly supported by the scheme sponsor. They receive little or no educational support and have little support from professional advisers.

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?

We surveyed our members to identify the principal barriers. The reasons cited were:

Lack of access to trustee training events:	21%
Qualifications are not at the right level:	32%
Inadequate support from the scheme sponsor:	39%
Poor leadership from the board chair:	20%

Another reason cited was that trustees did not have sufficient time to carry out their duties properly.

We believe that that the existing TKU requirements are inadequate and there is in any event no clear enforcement action to ensure that they are being met. Closer regulatory supervision is required, and we suggest that a formal requirement for trustees to pass trusteeship examinations at Ofqual level four or above should be introduced. A formal CPD regime for trustees should also be introduced.

We have heard some anecdotal evidence that some potential trustees are concerned that some trustees are deterred by the onerous nature of trustee liabilities – particularly when schemes are wound up. However, a more worrying phenomenon is the number of trustees who mistakenly believe they are covered by the scheme sponsor's D&O cover. A greater awareness of the nature of trustee liability would be beneficial.

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?

A sophisticated understanding of pension scheme investment is rare beyond professional trustees with a professional background in this area. It should be remembered that investment strategies for Defined Benefit schemes are commonly complicated. In practice, trustee boards are heavily dependent on the expertise of investment consultants. In recent years, there has been an increase in fiduciary management, in which the function – although not the ultimate responsibility – of a scheme's investment management is delegated to a third party.

This is not to suggest that trustees should be considered exempt for the implementation of investment strategy. It is right that trustees should have sufficient technical expertise to challenge the recommendations made by their advisers. As we noted in our answer to Question 2 above, the most practical solution would be to require trustees to be subject to a requirement to complete examinations which would demonstrate a comprehensive understanding of pensions investments. The Pensions Regulator has also suggested that a professional trustee be appointed to every scheme, and where the sponsor has sufficient resources to make such an appointment, this too would be an effective measure. However, it must be borne in mind that currently there is insufficient capacity within the professional trustee sector for this to be practical. It is also true that many sponsors simply could not afford to make such an appointment.

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

The consolidation of Defined Contribution (DC) schemes is relatively simple, and there have been many cases of this within the Master Trust sector.

Within the Defined Benefit (DB) universe, however, consolidation would be a particularly complicated concept. It should be remembered that in recent years, two commercial consolidators emerged. Neither has ever written any business and one has exited the market altogether. We would suggest that until it can be demonstrated that the merger of DB schemes can be achieved in a sufficiently efficient manner this option should not be considered as a viable means of improving governance standards.

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

We surveyed our members, and 60% agreed that there should be a formal trustee register.

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

72% of respondents believed that such information should be provided via the scheme return.

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?

The current accreditation framework for lay trustees is reasonable. Applicants are required to complete two examinations at Ofqual level three and to complete 15 hours' relevant CPD each year. Applicants are also required to have completed the TPR trustee toolkit, although it should be noted that the Toolkit is out of date and requires extensive work to bring it back to its original high standard.

Although the accreditation requirements for professional trustees require a ‘fit and proper’ test, industry references and a more demanding CPD regime, the examination requirements are the same as those for accredited lay trustees. There really needs to be a more emphatic distinction between the requirements for lay and professional trustees. We would suggest that a dedicated trusteeship qualification at level six (equivalent to first degree level) would be more appropriate for professional trustee accreditation.

As noted above, the existing TKU standards (which PMI’s existing Certificate in Pension Trusteeship is designed to meet) are in our view no longer adequate. All lay trustees should be required to pass an examination set at at least Ofqual level four (Diploma level). For professional trustees, We would suggest that PMI’s Trusteeship Pathway would be a more appropriate requirement. This consists of the following examinations:

- Defined Benefit Arrangements unit
- Defined Contribution Arrangements unit
- Retirement Provision Certificate
- Diploma in Pension Trusteeship
- Professionalism & Governance unit
- Certificate in Pension Trusteeship

This would ensure that any accredited professional trustee is suitably prepared for all aspects of effective scheme governance.

9. What proportion of your trustee board are accredited trustees?

N/A

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?

We believe that it would be appropriate to require a third of all trustees on a board to hold a form of accreditation. In the case of Master Trusts, we believe it would be appropriate for all trustees to be accredited.

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?

We would define a professional trustee as an individual who is not employed by the scheme sponsor and who holds themselves out as providing trusteeship services for remuneration. Essentially, this is the informal description of a professional trustee that was first used by TPR in 2017.

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

We would define a professional trustee as an individual who is not employed by the scheme sponsor and who holds themselves out as providing trusteeship services for remuneration. Essentially, this is the informal description of a professional trustee that was first used by TPR in 2017.

Chapter 2: The role of advice

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

The Pensions Act 1995 requires trustees to prepare a Statement of Investment Principles (SIP), which sets out formally the rationale behind their investment strategy. This covers long-term objectives, attitude to risk and the extent to which ESG considerations influence investment decisions. The over-arching objective for trustees is to implement an investment strategy which best serves the interests of members. As a general rule, trustees tend to be risk-averse. In the case of DB schemes, this will see trustees taking a generally conservative approach to both asset allocation and stock selection. This can lead to confrontation with the scheme sponsor; after the triennial valuation, the sponsor will prefer the trustees to invest in riskier assets in pursuit of higher returns as this would justify a lower employer contribution rate. However, trustees will generally prefer less risky assets and this will ultimately require a higher employer contribution rate to compensate for lower returns.

The selection of funds in a DC scheme is formally set out in the Chair's statement. The trustees are required to explain why the range of funds best suits members' interests and will consider the relationship between charges and expected returns. The default fund is required to have an Annual Management Charge (AMC) of no more than 0.75%. During the accumulation phase, the fund is intended to achieve an optimum balance between long-term returns and short-term stability. There is also a requirement for a de-risking strategy as the member approached Normal Pension Age. This replaces assets such as equities. whose value over the short term can be volatile, with more stable assets such as gilts and corporate bonds.

Trustees invariably appoint an investment consultant to provide guidance on how best to implement the investment approach set out in the SIP. It is in practice inconceivable that trustees would make investment decisions without having received comprehensive advice beforehand. Were trustees to consider investing in unlisted equities, it would be because to do so was consistent with the approach described by the SIP. Trustees would need to be persuaded that investing in such an asset class served the best interests of the scheme's members.

Crucially, if trustees were to consider investing in unlisted equities, it would be because they were satisfied that to do so best served members' interests.

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

Respondents to our survey suggested the following:

Better trustee training about alternative investments	70%
More flexibility about management charges:	27%

Generally, there was a view that additional trustee training would be helpful.

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?

We asked: ‘To what extent would you rely on guidance from your investment consultant before investing in unlisted equities?’ Responses from our members were as follows:

Complete reliance: 31%

Some degree of reliance: 58%

Little reliance: 2%

No reliance: 9%

We do not believe there are grounds for supposing that investment consultants lack any technical understanding of unlisted equities.

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

We do not see any particular changes necessary in order to improve trustee decision making.

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’?

We asked: ‘How reliant are you on legal advice when making investment decisions?’ The responses from members were as follows:

Complete reliance: 13%

Some degree of reliance: 54%

Little reliance: 27%

No reliance: 6%

As has been noted above, the tolerance for investment risk will be described in the trustees’ SIP, and it is to be expected that investment decisions will be consistent with the views set out in the SIP.

As a general rule, trustees will tend towards a risk-averse approach. In the context of DB schemes, there will be an obvious desire to avoid sudden and dramatic falls in the fund value. For DC schemes, the Chair’s Statement is required to justify the rationale behind the selection of funds available to members.

Chapter 3: Barriers to trustee effectiveness

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?

Fiduciary duty is a well-understood concept.

The current regulatory environment is designed to support trustees making investment decisions that are appropriate for the scheme, and it does not necessarily follow that this will involve seeking higher returns for members. We would not consider it appropriate if trustees were pressured into investing assets that they did not regard as representing members' best interests.

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?

Trustees are absolutely committed to making investment decisions geared towards the long-term interests of savers. In the context of DC schemes, the design of the default fund is crucial PLSA research suggests that approximately 72% of savers remain in the default fund throughout their membership, so the fund's design needs to reflect the changing priorities of an accumulation phase than can last over four decades.

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

As has been noted above, the char's statement is an explanation of the rationale behind the selection of range of funds available to members. It covers the following:

Governance arrangements: The statement should outline the governance structure of the pension scheme, including the roles and responsibilities of the trustees or governance committee members. It should also detail any changes in governance during the reporting period.

Investment strategy: The chair's statement should include information about the scheme's investment strategy, the processes used to monitor and review investments, and how investment decisions are made in the best interest of the scheme members.

Default investment option: Any DC scheme used for automatic enrolment is required to have a default option. The chair's statement should provide information about this option, its performance, and any changes made to it.

Costs and charges: The statement should disclose the costs and charges associated with managing and administering the pension scheme. This includes investment management fees, administration costs, and any transaction charges.

Value for members: The chair's statement should assess the value that the pension scheme provides to its members. This might include information about member engagement, communications, and education initiatives.

Administration and communication: Information about the administration of the scheme, including the processes in place to ensure accurate record-keeping and member communications, should be included.

Assessing value for members: The statement should contain an assessment of the value the scheme offers to its members. This involves evaluating the costs, charges, and benefits provided to members and assessing whether these represent value for money.

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

Trustees' fiduciary duties do not necessarily discourage investment in alternative asset classes. Such assets would, however, need to be justifiable in terms of representing members' best interests.

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?

As has been noted above, trustees' fiduciary duties require them to more than focus solely on returns.

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?

The principal barrier is trustees' lack of familiarity with this asset class. A better understanding, achieved through trustee education, would address this.

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?

Trustees would welcome greater regulatory guidance.

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

We asked our members if lay trustees had sufficient time to perform their duties. They responded as follows:

Yes:	38%
No:	62%

A common complaint is that lay trustees have far too little support from the scheme sponsor. This constrains the amount of time they have to devote to scheme governance and also their access to education and training. A more robust regulatory regime, requiring sponsors to support trustees more effectively, would be very welcome.

Professional trustees are expected to have access to whatever resources they require to perform their duties.