ASSOCIATION OF CONSULTING ACTUARIES

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Dear all,

Joint DWP and HMT call for evidence on Pension trustee skills, capability and culture

I am writing on behalf of the Association of Consulting Actuaries in response to the above call for evidence.

Summary

- We wholeheartedly support the principle of looking for ways to improve the quality and capability of trustees. Having engaged trustees who are able to work with their advisers to critically assess their objectives and weigh up alternate solutions is the foundation of good governance and positive member outcomes.

- The situation is very different between trustees of DB and DC pension schemes.

- In DB schemes, we disagree with the premise that a lack of knowledge or skill is a key barrier to the trustees investing in alternative assets like unlisted equities. The main reason is that the regulatory regime that DB trustees have been operating in for decades has pushed them to look to take less investment risk, to increase the certainty of members receiving their benefits in full.

  If unlisted equities were a useful asset class to achieve these objectives, investment consultants would be advising on that basis and trustees would be getting training and exposure to this asset class.

- For DC schemes, trustees will have to consider what investment options are made available for members to select from. There is a delicate balance to be struck between offering a range of options and simplicity.

  It is usually easier for larger DC schemes to incorporate more illiquid assets as part of their default strategy or in the funds they make available. There is also a clear regulatory push in this direction, with smaller schemes being tasked with improving standards or consolidating. A higher standard for DC trustees, such as mandatory accreditation or requirement to appoint a professional trustee, may be a further stick to drive consolidation at a greater pace.

- Most industry participants can see the value that diversity brings to a trustee board and look for ways to encourage this, particularly in relation to lay trustees who are usually undertaking the role in a voluntary capacity.

  We would be cautious about any proposals that would make becoming a lay trustee too onerous given the challenges in recruiting and retaining them already. Any increased requirements should relate to the capabilities of the trustee board as a whole and not require each individual trustee to have the same skills.

- The clear majority of respondents to the ACA's survey on trustee skills and capabilities were of the view that:
  - Professional trustees should be required to be accredited (71%), but lay trustees should not (79%);
  - Trustees' fiduciary duties do not discourage investment in alternative asset classes (72%)
  - Fiduciary duties do not prevent trustees from seeking best returns for pension savers (83%);
  - Trustees would not find more direction from Regulators on investment decision making helpful (78%);

  The output of our survey is included with our response.

Our responses to your specific questions are set out in the appendix to this letter.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact Peter Williams, Chair of our Pension Schemes Committee, at peter.wiiliams@aon.com or 01372 733763.

Yours faithfully

Steven Taylor
Chair
On behalf of the Association of Consulting Actuaries Limited

APPENDIX

ACA response to Trustee skills, capability and culture evidence call

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

- In our experience, we expect trustees are aware that there are statutory knowledge and understanding standards associated with their role.
- Our ACA survey on trustee skills and capabilities, which received 208 responses, gave the following results to the question "Do you consider that you meet the knowledge and understanding requirements expected of trustees?"
  - Yes = 63%
  - Mainly = 11%
  - In some areas = 7%
  - Not applicable = 19%
- It is likely that, when they first became a trustee, they will have been referred to The Pensions Regulator's ("TPR's") Code of Practice on Trustee knowledge and understanding and the Trustee toolkit.
- Most trustee boards supplement this with further initial training and ongoing training each year and when specific topics arise.
- The majority of trustees will return to the Trustee toolkit after completing it only when the content is updated and/or new modules are added.
- We would expect that all professional trustees would be aware of the standards that are expected of them.
- Trustees generally understand the standards when "in the moment", i.e. when they are being trained / reminded.
- Lay trustees, who may only serve on one scheme and attend a very small number of trustee meetings each year, may struggle to keep as up to date on standards and current issues compared to professional trustees.

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

- In most cases, yes, but it is not universal.
- While many trustee boards have high levels of knowledge and understanding, there is a wide range between trustees boards and individuals. It can often be topic specific, e.g. they may be strong in certain areas, but weak in others, although the combination of skills can be good. We would tend to view a trustee board's mix of skills as a whole and recognise that lay trustees can add value to the debate beyond the technical issues.
- Some trustees can be passive and are usually undertaking the role out of a sense of duty or because they have had some implicit or explicit pressure applied (e.g. from sponsor management, other members, existing trustees, etc). While they will tend to diligently attend meetings, they will probably not invest significant time outside of meetings to maintain/improve their levels of knowledge. They may have good knowledge of the history

of a scheme and good connections with the membership (they are usually also members themselves) so can bring a valuable perspective to the operation of a scheme.

- Some lay trustees rely heavily on either the chair/ professional trustee, external advisers, or in-house team (where there is one) to make decisions and for guidance/reassurance.
- It is not just knowledge and understanding that vary. Engagement levels at meetings, and softer skills (e.g. negotiation, communication ability, etc), are also very mixed. It is not unusual for a small minority of trustees not to contribute at all during meetings or reply to emails.

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?

- The greatest barriers to improving trustee knowledge and understanding are time and resources.

- Larger schemes will tend to provide greater levels of resources and support to their trustees, and these are usually associated with larger employers who will find it easier to allow lay trustees, who are also employees, suitable allocations of time to devote to their role. The WTW 2023 Trustee Governance survey, which would tend to capture a greater portion of larger schemes, indicated that trustee Boards are reviewing their effectiveness more frequently – two-thirds are now running annual self-assessments and 3 in 10 are externally assessed at least every 3 years.

- Many lay trustees will only serve on one trustee board and will be doing so on an unpaid basis with varying levels of employer support/encouragement. However, these trustees are usually members too, so are very aligned with seeing the scheme operated properly.

- Suggestions on what the government could do:
  - New modules being added to TPR's trustee toolkit annually (for new topics or regulatory updates) and periodically for other topics (e.g. valuation module every three years)
  - Provision of TPR trustee checklist each year based on recent developments, key messages, reminders

  We are not in favour of any material increase in the level of reporting/governance for trustees as it is likely to act as a barrier to recruiting/retaining trustees which we see as vital to having a well-diversified trustee board.

- We have not seen lots of evidence that trustee liability puts off many potential trustees. The challenge to finding member-nominated trustees tends to be more influenced by the time pressure of performing the trustee role alongside the 'day job' and the perceived complexity of pensions and knowledge that is required. This can be exacerbated where schemes closed a number of years ago and the number of employees with benefits in the scheme is low (although looking to include pensioner member-nominated trustees can help address this).

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?

- No one will always have the right knowledge and understanding. New investments and products are constantly coming to market, driven by both regulation and market innovations.
- Most trustees will take investment advice in carrying out their duties. This investment advice will usually focus on initially understanding the trustees' objectives (and any restrictions that apply) before looking at an overall investment strategy (i.e. the mix of asset classes) before then selecting the underlying investment managers. The trustees' Investment consultants will usually provide training as part of each step of the process.
- Trustee boards on larger schemes will usually have more time and resources available throughout the process. There is also a big difference between DB schemes (where most take frequent investment advice and some schemes will have chosen the fiduciary management approach) and DC schemes (where schemes will review the investment offering to members less frequently, particularly as scheme size reduces).
- Ultimately, this comes down to the right education and training to build an understanding of an asset class and then the confidence to make an investment decision on whether or not to invest.
- We don't feel it is the lack of knowledge or awareness of an asset classes that results in trustees not investing in it, but whether the underlying asset class is attractive (relative to the trustees' investment objectives).

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

- There are differences between DB (where consolidation is reasonably complex, although there are an expanding range of options) and DC (simpler and more well-worn path)
- There are a range of potential conflicts of interest that can potentially arise. For example, lay trustees feeling a loss of role, professional trustees putting themselves out of a job or advisers promoting consolidation options that are more commercially appealing to them.
- DC trustees are often supportive of moving to a DC Master Trust but struggle to engage the employer, or the employer pushes back as it is "not a Trustee decision". The complications for DB schemes usually relate to whether the consolidation changes the underlying covenant strength.
- An increasing number of DB schemes are close to being able to fully secure their benefits with insurers and wind up. We expect this trend to continue.

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

- It isn't clear what problem this is trying to address or what having a register (beyond the existing Independent Trustee register and information on the scheme return) would achieve.

- Our survey showed a roughly equal split of respondents who were / were not in favour of keeping a register.

- In our view, it would be better for TPR to identify schemes where they have evidence that the trustees are not performing and look to engage directly, as opposed to placing additional requirements across all trustees.

- However, if the government decides it wants to introduce some form of regular declarations, central recording of trustee training, etc, then some form or register and reporting system would be required. We would query whether the cost/benefit of TPR running such a system would be worthwhile.

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

- We don't have a strong view, but our initial preference would be to use the scheme return to avoid introducing an additional standalone reporting requirement. The optimal solution will depend on what information will be gathered and how easy it would be for the scheme return system to be updated to gather this.

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?

- We support the requirement for all professional trustees to be accredited and for this to be encouraged, but not mandated, for other trustees.
- We believe that as most professional trustees will have existing experience in dealing with pensions and the role of a trustee (e.g. as pensions managers, consultants, lawyers, actuaries, etc) that the bar for accreditation is not too difficult for them to achieve.

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

- We do not have any statistics on the numbers of non-professional trustees who have become accredited.
- However, we have seen the growth in the number of professional trustees. For example, Isio's 2023 survey showed that amongst 10 of the largest professional trustee firms the number of appointments has grown from 1,900 in 2020 to 2,100 in 2022, with the number of trustee directors increasing from 246 to 290 over the same period.

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?

- Other than all professional trustees being accredited, we do not believe that there should be a minimum required proportion of accredited trustees. However, if the government were to introduce this, we would set any requirement at the lowest level, i.e. "at least one".

- For DB schemes we feel that extending this requirement to all trustees would introduce additional barriers to recruiting trustees and encouraging diverse boards. Increasing barriers that result in the loss of member and sponsor nominated trustees, who can bring a wide range of useful skills and insights to trustee board decision making, is potentially counter-productive. While some may lack technical pensions knowledge, this is usually the areas that their advisers are best placed to support.

- We recognise that for DC schemes there is an explicit policy encouragement to drive consolidation and would be less concerned with introducing a minimum proportion of accreditation.

- We would expect that the majority of trustees of a Master Trust to be accredited.

- For the largest schemes (including Master Trusts) the government may find a requirement to have at least two professional trustees (who are not connected, i.e. don't work for the same firm) may be a more proportionate approach.

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 believe it would be reasonable for more rigorous standards to be applied to professional trustees.
- One of the ways this could be achieved is through a requirement for accreditation. As noted in our answer above, we do not believe that the current accreditations are a particularly high bar. While this is good for encouraging a wide variety of individuals to consider accreditation, it is probably not driving a significant change in behaviour.
- While the accreditation process should be subject to regular review and refinement to address any observed deficiencies, setting the bar at too high a level may discourage the supply of professional trustees (which would work against any desire to increase the number of schemes which involve a professional trustee).

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

- We would expect a definition that looked to capture what is set out in the current guidance would be a reasonable basis, i.e. being paid (or looking for work that is paid) to act as a trustee/trustee director across multiple unconnected schemes and of which they are not a member.

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?

- For DB schemes most trustees approach investment decisions by starting with considering their overall objectives, selecting the most appropriate mix of assets and then selecting their preferred implementation approach (e.g. whether to invest directly, via pooled funds, what level of delegation, active vs passive, which manager(s) to use, etc).
- For DC schemes the situation will be different as primary focus is usually on designing the default strategy, what other non-default options would be offered and whether a wider range of “off the shelf” or “whole of market” funds may be accessed.
- Trustees will tend to rely on their advisers to help them through this process, which will usually be their investment consultant. Part of the investment consultants’ job is to help filter out all of the various asset classes and implementation approaches to help the focus the areas where the trustees need to make decisions and what support they need to understand their options. Trustees would not expect to be trained on every asset class, but only on those that might form part of a solution or offering which meets their overall objectives.
- Training on investment strategies and asset classes is generally provided by investment consultants. Additional training can be provided by asset managers and legal advisers.
- There tends to need to be several training sessions to give a trustee board the confidence to be able to make investment decisions on more complex and/or novel asset classes and products.
- Some schemes will ask other pension schemes to talk to them about their experiences (although this tends to happen more with larger schemes).
- Professional trustees can help give some trustee boards confidence with new asset classes.
- Regulated advice is needed on some decisions (e.g. S36 advice for pooled fund investment) but bigger decisions such as strategic asset allocation do not require the same.
- The considerations on investment strategy and implementation are different between DB and DC schemes, so most investment consultancies have specialist teams.
- In relation to unlisted equities, trustees would likely receive training on this asset class if they were going to be investing in this asset class as part of their proposed strategy or as part of the funds they would offer to members. However, many will not be trained on these assets if they have been filtered out by their investment consultant (as they don’t have the right risk/return or other required characteristics, e.g. liquidity).

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

- The key barriers to trustees investing in unlisted equities are not really to do with a lack of trustee training or understanding.

- The main barriers are that unlisted equities:

  - don't meet the trustees risk/return objectives. This is particularly the case for DB schemes where the direction of regulation over the last few decades has been focussed on trustees taking less risk (unless it can be confidently underwritten);

  - are not cost effective, even taking into account return potential;

  - hard to implement or access. This is more of a challenge for DC schemes (platforms, liquidity, etc) and smaller DB schemes.

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 would expect most trustees to use investment consultant advice to support on any decision around allocations to unlisted equities.

- Trustees will also rely on their investment consultant to help with the education and understanding of the asset class, covering risk and return and operational considerations, which are complex.

- We do not believe there is a lack of knowledge amongst investment consultants on unlisted equities or this is a contributing factor to the current levels of investment by pension schemes in unlisted equities.

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

- Investment management is a highly competitive area which is constantly evolving. We don't have any specific changes to suggest that would improve pension scheme investment 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'?

- Trustees would most commonly take legal advice in relation to investment decisions around reviewing investment manager contracts and when investigating the structuring of more complex arrangements.
- We expect most trustees to work with their investment consultants on risk tolerance. They would usually look to their lawyers to confirm whether any investment was legal and whether the terms of any agreement are commercially acceptable.
- Given the high level of regulation in the pensions industry most trustees do look to act prudently. In particular, the overall direction of DB pension regulation has been to encourage trustees to take less investment risk.

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?

- While the high-level concept of looking after members' interests is widely understood, the position is more mixed when it comes down to more nuanced points on what factors should be taken into account.
- Some trustees are strict with the definition, i.e. we need to pay members' benefits and therefore we will not take any additional risk nor excess costs. This could preclude them from looking at some investment options that may be in the better interests of members in the long run.
- Most trustees understand that there are usually no "free lunches", i.e. higher risk usually comes at the price of higher risk.
- The divide between trustees of DB and DC schemes comes into play here. DB regulations actively promote trustees to take less risk, so would need to be fundamentally changed to encourage them to pursue higher returns. DC trustees, while potentially nervous about having too aggressive a default approach, are usually more relaxed about including higher risk/return options on a self-select basis for members that want to make a choice.

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?

- For DB scheme trustees, the focus is on getting to full funding on a low dependency, or stronger, basis. Many schemes are close to, or at, that point and trustees will invest in a prudent way to preserve the funding position or to get ready to transact with a bulk annuity provider. This is aligned with the last 40+ years of regulatory travel, so making changes that would increase trustees' investment risk appetite would be required (which is addressed in the DWP's call for evidence on options for DB schemes).
- DC scheme trustees have generally evolved their frameworks around VFM and strategy reviews to focus on member outcomes. This can be limited by a) Bandwidth / governance budget, b) Product availability (e.g. on platforms including Master Trusts), and c) Benefit complexity (e.g. underpins)

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

Trustees will usually look to balance up these issues as part of their investment decision process in light of their objectives. Other considerations are:

- Active management carries higher fees with the prospect of generating above benchmark returns net of fees. Investment consultant input is crucial in the selection, appointment and retention of a manager on an actively managed basis.

- Higher fees are attached to most alternative asset classes which needs to be balanced by the expectation of higher and/or diversified returns relative to listed assets.
- For DC many VFM frameworks now consider price, performance, and other factors (e.g. service quality). However, not all do, and we also note that when employers (with input from trustees) are considering Master Trusts, price is very often the key factor, with opportunities lost on basis points of fees.

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

- For DB schemes, it depends on the investment and funding strategy selected (noting the regulatory backdrop). For example, if the trustee and sponsor agree it is in the members' best interest to transact with an insurer in the near future, it would not be appropriate to invest in illiquid assets which have high haircuts when selling ahead of their normal run-off term.
- For DC trustees, we don't believe this is the case.

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?

- In terms of high-level considerations around balancing up investment risk and reward probably not.

- However, there can be more contentious areas where the nuances of fiduciary duties can come to the fore. One example of balancing long-term interests vs best returns is when trustees are considering climate-related risks. High profile asset managers are pulling out of the Net Zero Asset Manager Initiative, citing financial materiality. The challenge is looking to invest with a 10+ year mindset and what is best for the wider economy in the future vs the potential impact on returns in the shorter-term.

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?

In this context, we believe the most influential actor is the trustees investment consultant. As noted in previous answers, it is not that the investment consultants are unable to provide advice on illiquid assets or experience material barriers in providing this advice, it is more that the characteristic of the illiquid asset means that it is not an optimal asset to recommend as part of any proposed investment strategy for each client.

- If illiquid assets are being proposed, the main challenge is usually around education and getting trustees comfortable that they fully understand what they are investing in and how the asset class will operate. Much of the complexity of private markets comes from the operational governance: managing drawdown requests within relatively short time periods.

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?

- In general, we don't support placing limits or restrictions on trustees' investment flexibility.
- As most trustees will rely on investment advice, it is hard to see what further guidance could be provided (in addition to the large amount of existing guidance) that would be helpful.
- The DC Value for Money framework is the best avenue to work on shifting the focus from cost to value. This is not an easy undertaking, given costs are usually known at outset when value will usually become evident over time.

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

- Support varies from employer to employer. Lay trustees can be under time pressure to complete both the day job and their trustee duties, especially when it comes to time for personal training and development (i.e. beyond attending trustee meetings).
- Lay trustees can be very "meeting" focused in many cases, rather than ongoing development of ideas and actions or engaging outside of trustee meetings. However, trustee meetings are where those trustees with less technical pensions knowledge can add the most value, in bringing a wider perspective and knowledge to the decision-making process and exploring issues and options with their advisers.
- A strong chair can be beneficial, in ensuring that all trustees have time to prepare for and attend meetings and to pick up actions and training outside of trustee meetings.
- There is a delicate balance of making changes that force more work on trustees in an attempt to increase standards, e.g. mandatory accreditation or minimum annual training requirements, may prove to be counterproductive if it ends up acting to discourage lay trustees from volunteering.
- Professional trustees will normally have enough time available.

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