Freedom & Choice
A Regulator's Perspective

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Agenda

- Impact on DB of freedoms
  - Steady as she goes but keeping a watching brief
- Tax relief issues
  - Our review of Master Trust communications
- 21st Century Trustees
  - Over reliance on advisers?

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Preliminary Research and Scenario Testing – pre-freedoms

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Impact of pension flexibilities on DB schemes

Initial risks

- More members requesting information
- More members choosing to transfer at 55
- Potential impact on scheme's liquidity requirements & investment strategy
- Greater interest from employers to promote transfers to reduce exposure to scheme risks.

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The Pension Regulator’s guidance

Aims:

- Help trustees ensure they have appropriate processes in place
- Prompt schemes to monitor and understand the impact of transfers and subsequent risks
- Identify information trustees must provide members and checking financial advice obtained.

Regulatory guidance

DB to DC transfers and conversions

April 2015

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Potential impact on funding over next 5-10 years

- Centred around assumptions in HMT's 2014 Impact Assessment and variations to it : doubling of take-up, concentration among different age groups / pot sizes, adverse selection, underfunding in TV

  - Likely minimal impact to funding outcomes across the DB universe

  - Any significant impact to funding might be driven by a 'run on the scheme' / mass-level take up . However the findings indicated an improvement in funding level relative to the baseline under 'central' economic assumptions

  - Some indication of greater risk to poorly funded schemes.

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Experience to date

Purple Book:
DB Pensions Universe Risk Profile 2015

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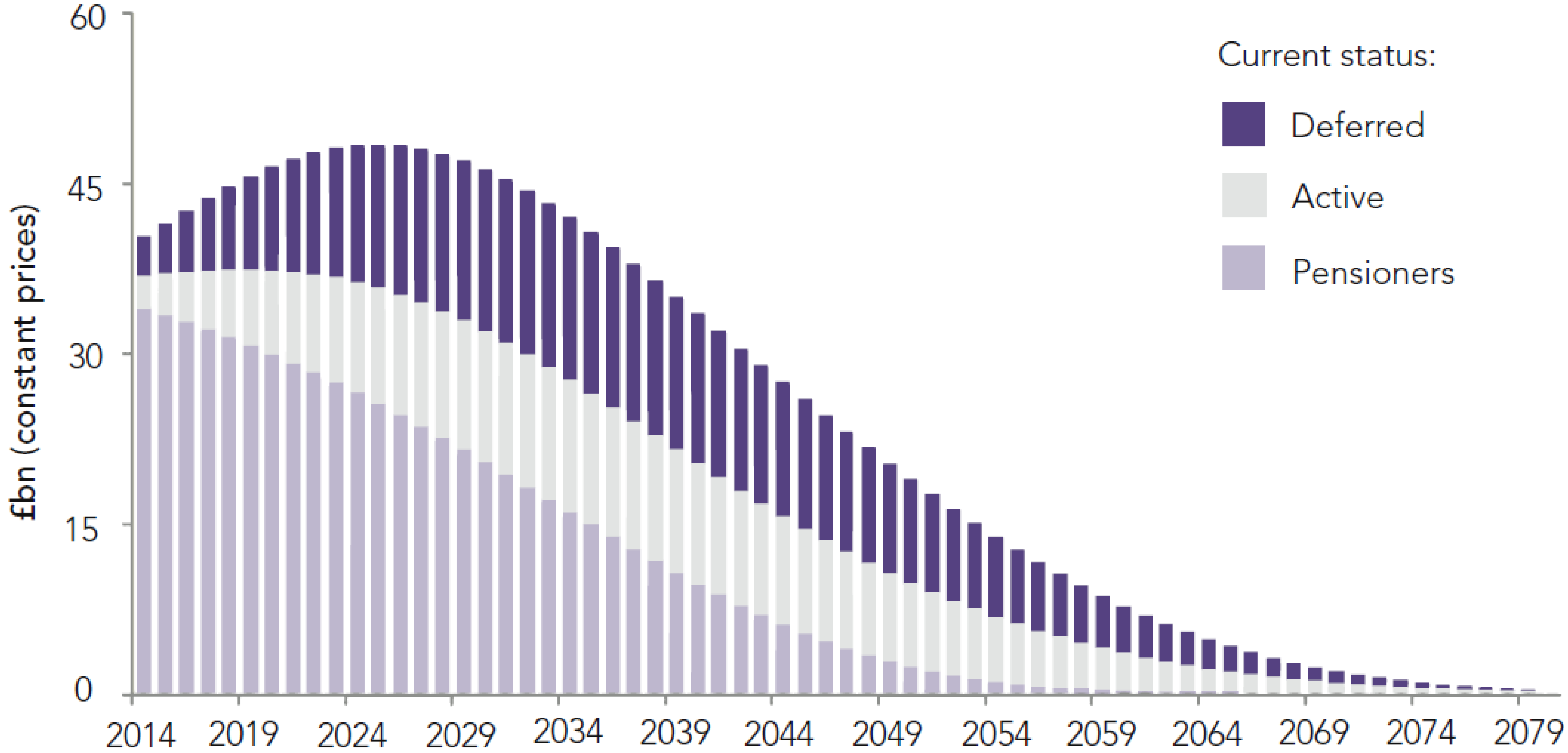
Estimated aggregate cash outflow from DB schemes



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The future and ongoing monitoring

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Tax relief for lower paid workers

- NPA
- RAS


Pensions minister asks employers to plug tax relief gap


Pensions minister presses regulator to better protect low earners

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Tax relief example

A weekly paid member of staff on a basic salary of £10,400 per annum:

- is a member of a pension scheme where only basic pay is pensionable,
- and is paying a 1% member pension contribution (ie 1% of £200 per week).

Under **Net pay arrangement**:

- the full £2.00 per week is deducted from their gross pay and paid into their pension pot and
- as the individual earns **<u>under</u>** the HMRC personal tax allowance threshold, they don't pay income tax and are not able to claim any money from HMRC
- So, the cost of the £2.00 pension contribution to the employee is £2.00.

Or, under **Relief at source**:

- £1.60 per week is deducted from net pay and paid into the pension scheme,
- the pension provider would then claim £0.40 from HMRC
- and a total of £2.00 per week is paid into the member's pension pot
- So, the cost of the £2.00 pension contribution to the employee is only £1.60.

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Communicating with members about tax relief

- We expect clear and accurate communication for members
- 2 tax relief arrangements currently available – net pay and relief at source
- Affect higher and lower paid workers in different ways
- Specific information for lower paid workers if they use net pay or higher paid workers if they use relief at source
- Trustees must take action if their communications aren't clear.

http://www.thepensionsregulator.gov.uk/trustees/tax-relief-communications-to-members.aspx

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Master Trusts - tax relief arrangements

- Ensure that they are clear on tax relief arrangements and that this information is accessible to members
- Review the communications they provide for participating employers to use
- We will review the communications issued by master trusts on tax relief
- Requirement for clear, accurate and prominent communications on tax relief.
- When a master trust asks to join our list we will ask them to provide copies of their communications for us to review to ensure they are in line with our guidance.

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Master Trusts - tax relief arrangements

- Employers and their advisers may not realise that there are 2 ways that tax relief can be applied:
  - Net Pay Arrangement
  - Relief at Source ('not Net Pay Arrangement')
- Many pension schemes only support one tax relief method
- Some pension providers allow the employer to choose either method.

www.tpr.gov.uk/what-to-consider-when-choosing-a-scheme.aspx

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21st Century Trustees

Their relationship with advisers

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Scheme and trustee characteristics impact on structure and effectiveness of trustee boards

Size

Larger

- Formal strategies and clear roles
- More frequent interaction
- Greater skill and experience

- Informal approach
- Less likely to have skills & experience
- Less likely to undertake regular training
- Less likely to challenge advisors
- Employer-dominated boards more common

Smaller

Scheme type

DB or hybrid

- More time spent on trustee duties overall
- More likely to be engaged with roles & responsibilities

- More likely to not know duties & responsibilities
- Less likely to scrutinise investment strategy

DC only

Trustee type

Professional

- Greater skills & experience
- Formal structures & procedures
- More time devoted to duties
- More likely to challenge advisors

- Less likely to have full knowledge & skills
- Less likely to consistently attend meetings/carry out role

Lay

What makes an effective trustee board?

- ✓ Motivated individuals
- ✓ Balance of skills and (relevant) experience
- ✓ Balance of ‘interests’ (MNTs and EATs)
- ✓ Knowledge – acquired and refreshed through a formal training approach
- ✓ The right general skills – analytical, challenging, good communicators
- ✓ A chair who leads, guides, can challenge and negotiate
- ✓ The right mix of personalities to work well together.

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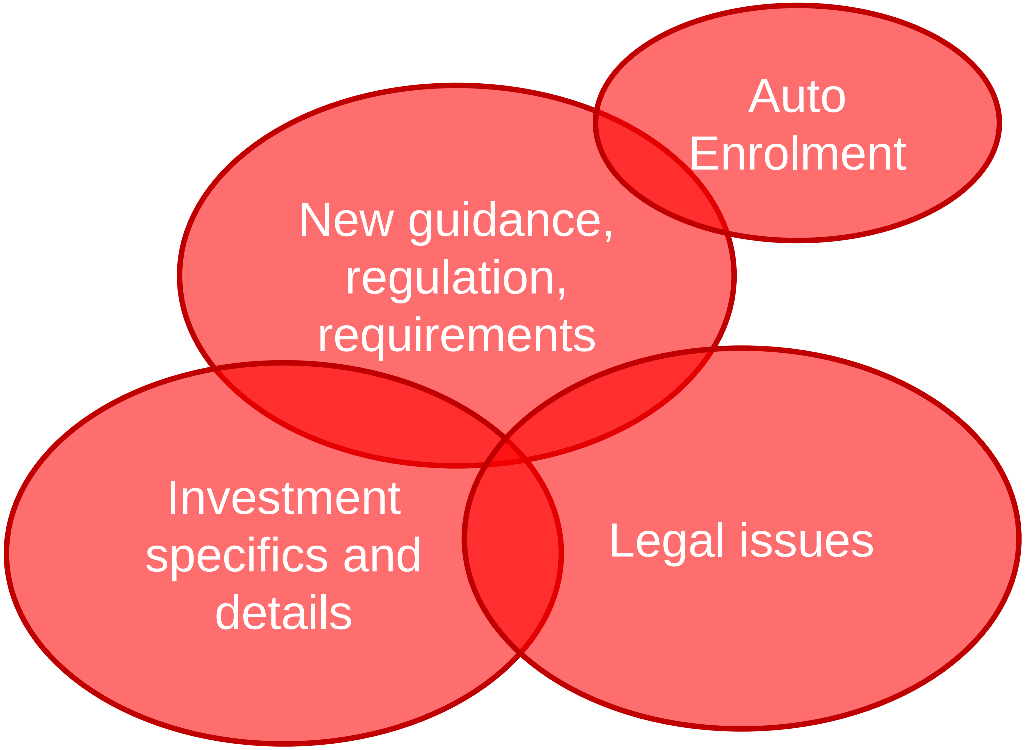
Weaknesses and gaps in trustee knowledge and skills

Broad areas of perceived weakness most commonly described:



Quant survey results: The largest gaps between perceived knowledge & importance were for:

- Pension scheme **investments**
- Pensions **law**
- The **role** and **responsibilities** of trustees

Knowledge gaps in these areas often result in heavy reliance on external advisors

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Overview of external advisors used

- Use of professional advice on specialist matters considered critical
  - Quant data shows 89% use at least one advisor
- Trustees believe that advisors bring:
  - Expertise
  - Independence
  - Ability to keep abreast of changes
- Advisors were **often said to be present at all or most trustee meetings**, if only for a small percentage of the session
- Selection of advisors varies from highly organised/transparent to informal (particularly small schemes)

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Risk that boards do not scrutinise advice, potentially to the detriment of members' interests

Quality of relationship between trustees and their advisors is varied

- Trustees reported some instances of **clear disagreement** with advisors
- Resulting in benefits to the scheme and it's members

- While not necessarily disagreeing, trustees said that they often **scrutinised advice**
- Relationships described as discursive

- Some schemes reported common acceptance of advice without any detailed consideration

More scrutiny ⟷ **Little / no scrutiny**

Lack of perceived need or desire to challenge

- High levels of trust in advisors
- It is the 'right thing' to listen to them

Concerns about ignoring 'professional advice' and being held accountable for resulting poor outcomes

Lack of confidence to challenge

- Unsure about the details of issues such as investments or pensions law, so feel 'unable' to effectively challenge

Increasing understanding of **both** the role of advisors vs. trustees and technical topics will increase likelihood that schemes will become better at scrutinising advice

Time for questions

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