Broadstone

Call for evidence Response

Pension trustee skills, capability, and culture: a call for evidence

September 2023

Guide and Information

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Executive Summary

We are pleased to be able to respond to this consultation on the skills and capabilities of trustees, especially in the context of investment decisions.

We accept the tenor of the debate that is being had to challenge the decision-making ability of the existing population of trustees and question whether they have the skills and capacity to assess the use of unlisted equities in their asset allocation.

We represent c450 primarily small, single employer defined benefit pension schemes. Their goals are clear. To provide the security that has been entrusted to them to provide members with their deferred pay. This creates a delicate balance between risk and return. They also need to consider the pressure on their sponsor to meet any funding shortfalls caused by poorer than expected investment returns, and the prevailing winds of longevity, interest rates and inflation.

The Trustees key goal is to have as much money as they need to meet those promises – it is not to generate a profit and make as much money as they can.

There are a number of reasons why Trustees may shy away from using unlisted equities in their investment portfolio. We list some observations below but fundamentally if return and risk can be managed with assets that are more transparent, widely traded, liquid and frankly easier to understand and explain to members then why would or should trustees be encouraged to chase returns at higher cost and risk.

1. Lack of Liquidity: Unlisted equities are not traded on a public exchange, which can make them more difficult to buy or sell quickly. This lack of liquidity can pose a risk if the trustees need to sell assets in a hurry. This has been borne out and is front of mind following the rate rises experienced in autumn 2022.
2. Valuation Challenges: The value of unlisted equities can be harder to ascertain because they are not subject to the same level of public scrutiny as listed equities. This can make it difficult for trustees to accurately assess the value of their investment.
3. Risk Profile: Unlisted equities can be higher risk than listed equities. They often involve investing in smaller, less-established companies which can be more vulnerable to market volatility and business risks.
4. Lack of Transparency: Unlisted companies are not subject to the same disclosure requirements as public companies. This can make it more difficult for trustees to obtain the information they need to make informed investment decisions.
5. Resource Intensive: Investing in unlisted equities often requires more resources in terms of due diligence and ongoing monitoring compared to investing in listed equities. This can be a challenge for pension schemes with limited resources.
6. Higher costs: Trustees must also balance cost, and investment in private equity will increase adviser costs, manager charges and potentially PPF levies.

Trustees would need to balance these potential challenges against the potential benefits of investing in unlisted equities, such as the potential for higher returns and portfolio diversification.

As with other concurrent consultations into the pensions framework we think there are some positive ancillary benefits that could arise for pension scheme trustees.

- Greater accountability for their skills
- Regulatory support for allowing additional time to undertake the role
- A review and refresh of the trustee training framework
- Recognition of the increased professionalism of trustees could result in higher quality trustees

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Responses

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

In general, and only speaking for our clients, yes. The Trustee Knowledge and Understanding (TKU) rules have been around for many years and the toolkit core module gives a clear expectation of what trustees need to understand. The requirement for new Trustees to get up to speed in 6 months and Chairs quicker are also well understood. We have also launched a training programme which mirrors the toolkit modules (with topical updates) and expands into other new and breaking areas where Trustees need a period to get up to speed before fully understanding a topic. This reinforces the expectations and requirements on trustees.

What could be clearer is the ongoing training required to execute the role. Much of it will be either “on the job” as situations arise or topical updates via industry group or advisers.

TPR could do more in this area. The TPR toolkit is a little dated and could do with more regular updates with a shorter streamlined core module supplemented by topical updates. It is surprising that TPR doesn’t do more outreach in this area and be more clearly bannered/advertised as essential TKU learning.

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

In our view the vast majority of trustees do meet the TKU requirements. Some trustees have a greater interest/aptitude for the role in general or particular aspects of it. This is to be encouraged, as that way a board is more likely to have specialisms where the load can be shared throughout the board. To say some types of trustees are better than others is difficult to say. We are also not clear on what you mean by “types”.

Within the lay trustee body we do see a range of people and professional backgrounds. We believe a high proportion come with a level of experience and motivation which provides invaluable insight into the board dynamic. In some cases pensions specific knowledge may be low (they probably couldn’t calculate a leaver’s benefit or conduct a valuation) but they will bring knowledge of negotiation, dispute resolution, GDPR, compliance and cyber security at a level which could be lacking even among their advisers. It is this team dynamic that can make a board operate well.

Professional trustees are assumed to have a greater depth of knowledge (after all it is their day job), and therefore the expectations from fellow lay trustees and also professional advisers is higher. However, we have to accept and understand that some have also come from specialisms of pensions law or actuarial practices (most commonly) and while they should be well informed they may have shortcomings across some aspects of their understanding. It is often difficult to discern these and for professionals to admit confusion or uncertainty. In some respects professional trustees from outside the industry (we have experience with trade unionists and company secretaries to name), that have a good understanding of the dynamics at play without the deep understanding, often provides a good challenge to advisers without getting bogged down in some of the irrelevant minutiae.

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?

Trustee liability is probably not well understood and if it were better understood may put some off. Although the protections for honest behaviour do exist, the real risk on the individual can be overplayed.

Barriers

- **Time Constraint**s: Being a trustee is for many a voluntary position, and individuals might have other professional or personal commitments, limiting the time they can dedicate to the organisation. Mandatory time off should be allowed for. 2/3 days a year for pension work. Where this is specified in deeds this should be properly recognised and allowed for when appointing trustees.
- **Recruitment Challenges**: Identifying and attracting capable and committed trustees can be challenging. We know TPR is doing work here via EDI but this is still a challenge.
- **Reluctance to Change**: Some boards can be slow to adapt to the changing world preferring to continue with old practices. Adopting change should be encouraged from the top down.
- **Inadequate Oversight**: It has long been difficult to objectively assess board effectiveness, only after the event when things have gone wrong, and even then only judged in hindsight. This is a difficult area as trustees will oppose closer oversight but TPR could be clearer in its expectations of best practice, the long awaited general-code will assist with this and could act as a catalyst for many schemes to assess themselves against a standard.

To ensure that all trustees meet expected standards, the government can consider the following measures:

- **Review and refresh of standardised mandatory Training**: the training should cover legal obligations and duties, investments and funding, governance best practices, and ethics.
- **Code of Conduct**: TPR could develop a clear and enforceable code of conduct for trustees that outlines expected behaviours and responsibilities.
- **Support and Resources**: Providing resources, guidance, and mentorship to new and existing trustees to enhance their capabilities. As noted above TPR could do more to present information as meeting the Trustees' TKU requirements.
- **Regular Assessment**: Implementing periodic assessments of trustee performance and conducting board evaluations to identify areas for improvement.

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?

Increasingly, Trustee Board compositions within the own trust occupational pension scheme sector have professional trustees who can bring investment expertise and knowledge to investment decision making. This is also the case for Master Trust trustees where professional trustee board composition would be expected to be even higher compared to the own trust sector. Within the DC segment of the market there is an increased appetite for schemes to consider and invest into illiquid (or private market) assets. This is also true for DB schemes which remain open to accrual. Professional trustees will on average be more familiar and have more knowledge on public market investments versus private market investments. In order for affected trustees to have the right knowledge and understanding, so as to invest in the full breadth of investment opportunities (and here focusing on private market assets) there are two key actions trustees can do. Firstly, trustees should ensure their investment advisors are suitably qualified and have experience advising on these types of assets. Secondly, trustees should develop their own knowledge and understanding of asset classes they are less familiar with.

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

We suspect you mean DC schemes here and will focus on that. Our clients are primarily in the sub £100m market (with a handful of larger schemes). This means they are very aware of the requirements to assess their quality and consider consolidation if needed. We have seen the evidence published which puts this into question and are surprised and disappointed about this. We can only assume that the majority of these schemes are SSAS where the level of regulation is woefully low. The removal of the requirement to have a pensioneer trustee was a misstep leaving schemes open to operate in ignorance of the rules and, potentially, to the detriment of their members.

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 – this would be a good idea. Being able to target information, guidance and support directly to Trustees would be an excellent way of assisting them in understanding the pensions landscape and the full range of options and areas to consider to improve their member's benefit security

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?

This would be best achieved through the scheme return to ensure central control and return and annual renewal. Many trustees do expect day to day tasks to be delegated to their providers, administrators etc, and so it risks being caught between two stools.

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?

We are not a trustee firm and so are not familiar with the accreditation process.

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

Our estimate is that across our clients of c500 around 40% will have some professional representation. This person will most commonly be the chair.

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?

Any mandating should be avoided as this risks losing good quality unaccredited trustees. Perhaps unaccredited trustees can justify their continued involvement in the scheme with a declaration of quality and skills requirement.

However, if schemes are required to have at least one accredited trustee there could be a sliding scale across the scheme size where more accredited trustees are required upon reaching the largest schemes. Increasing the number of non-MNT on the board could inadvertently create an unwelcome imbalance for schemes that struggle to attract trustees.

The cost of a professional trustee may also be prohibitive to smaller schemes and counter productive.

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?

Much has been done voluntarily by the professional trustees. However, if there is to be any mandating of professional trustees on boards then this needs to move to mandatory accreditation. This needs to cover higher levels of qualification to demonstrate their knowledge, impose a requirement for them to act ethically and in the interests of the members to avoid conflicts of interest and a CPD (or similar) ongoing requirement. This may be resisted by those with many years of experience but the risks of poor quality players entering a growing market would need to be balanced with the relatively minor inconvenience of passing a test.

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

A person who is paid to be a trustee and markets themselves as providing services as a trustee.

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

One key source where trustees would receive advice in relation to unlisted equites is from their investment adviser. Investment managers may too provide advice and recommendations to trustees for them to consider. Unlisted equity investments are more difficult to understand versus public listed equities and the key reason here is information and disclosure. Investors investing into private markets face a much greater due diligence burden versus investors investing into public markets. Trustees should ensure that an adequate review/due diligence is carried out for any proposed new investment and investment managers are challenged with respect investments they bring forward.

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

Regulations could set-out minimum levels of due diligence required before making any investment or put in place best practice steps to be followed when considering unlisted equity investments.

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?

Trustees would typically seek advice from investment consultants when making decisions to invest in unlisted equity. Different advisory firms may have different levels of knowledge and understanding of different asset classes. Advisors within private markets may also have different levels of expertise within the asset class, for example different geographies and the underlying asset class.

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

Increased transparency and reporting information provided by managers.

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'?

No answer as not Trustees.

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?

We assume you're referring to DC schemes. We do believe the fiduciary duty to act appropriately for the beneficiaries is well understood and schemes do consider the risk and return of investments in their default fund.

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?

All trustees will make investment decisions based on the long-term interests of their scheme. The investment strategy and subsequent asset allocation are based on maximising member benefit security.

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

Trustees will typically consider the expected net returns when making investment decisions. That is the expected return of an investment, less the expected costs that arise.

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

We do not believe this is the case. Lack of understanding on the asset class or potential risk adjusted returns that can be achieved by investing into the alternative assets is likely to be a reason why alternative assets are not considered by trustees (in situations where they ought to have been considered).

For DB Trustees the desire to invest in liquid assets has been reinforced by the gilt yield rises across 2022 where having liquid assets was a distinct advantage in meeting collateral calls. It is also advantageous when looking to secure buy-out deals in a competitive market.

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?

As per above, a key reason alternative assets are not included in situations where they ought to have been considered is likely to be because of lack of knowledge/understanding.

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

As investors allocate more capital into illiquid asset strategies this is likely to mean more trustees would be comfortable and wish to consider them where it is appropriate to do so.

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?

Best practice guidance may be helpful to set out the key steps trustees should be taking.

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?

See above question 3 regarding lay trustees. Professional trustees have an obligation to make time.

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