TUC

trustee network

member trustee news

Summer 2011

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Published by:
Trades Union Congress
Congress House
Great Russell Street
London WC1B 3LS

Contact
Jennifer Mann
020 7467 1222
trusteenetwork@tuc.org.uk

Jess Hurd/reportdigital.co.uk

Does **your** pension fund support **fair pay**?

The TUC and a number of affiliated unions are supporting FairPensions' "Just Pay" campaign on Living Wages. A Living Wage is the minimum hourly wage necessary for housing, food and other basic needs for an individual and their family. Living Wage rates are based on Minimum Income Standards methodology and take account of real living costs for essential goods and services. Within London, the Mayor's Office announces the Living Wage figure each year - currently £8.30 per hour. Outside London, the Centre for Research in Social Policy at Loughborough University has calculated a single rate for the regions which is £7.20 per hour.

The aim of the Just Pay campaign is permanently to embed Living Wage standards in the UK's private sector, beginning with the FTSE 100 companies. The campaign aims to secure the support of major investors including pension funds and City fund managers as lead activist investors, as well as to mobilise the public. The investment industry, including pension providers, has the potential to influence corporate behaviour

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Welcome to the Summer edition

Life continues to be difficult for many trustees, with no let up in the pace of scheme closures, and, for many boards, difficult discussions on pensions increases; the resignations of Airways MNTs have been well-covered in the professional press.

Meanwhile, in the public sector, talks are ongoing on the future of the schemes following Lord Hutton's report. A summary of Hutton's recommendations is given on page 7 of this issue. In his interim report, Lord Hutton expressed the hope that "reformed public service pensions can be seen as once again providing a benchmark for the private sector to aim towards". In the public debate over the government's proposed reforms, unions have highlighted the decline of decent pension provision in the private sector and have warned against a race to the bottom in pensions provision.

And finally, a reminder that the Trustee network conference is on Tuesday 15 November at Congress House in London. Confirmed speakers include Pensions Minister Steve Webb and Dr Paul Woolley, founder of the Centre for the Study of Capital Markets Dysfunctionality at the LSE, and there will as always be a good range of workshop topics. You can register an interest for the conference by contacting Jennifer Mann on jmann@tuc.org.uk.

Fiona Draper

Does your pension fund support **fair pay**?

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and is well positioned to encourage commitment to Living Wage standards. Pension providers take care of the savings of millions of working people who are uneasy about the rapid growth in wage inequality in many listed companies. The campaign gives expression to that concern and provides one practical remedy to resolve it.

The Living Wage is an investment which makes sound business sense. Employers who have already implemented Living Wage standards report clear benefits in employee retention, productivity and morale. Guy Stallard, Director of Facilities, KPMG Europe has described it as "a smart business move". In a London Economics survey of Living Wage employers, most employers reported significant decreases in staff turnover, substantial savings in recruitment and induction training, and lower rates of absenteeism and sick leave. One employer reported a 25 per cent drop in absenteeism among on-site contractors' staff following the introduction of the Living Wage. 80 per cent of employers believed that the Living Wage had enhanced the quality of work performed by staff.

Standard Life have already publicly committed to having negotiations with their contractors to allow them to become a Living Wage Employer across all UK operations, and a number of other major companies have also responded positively to a letter sent to them by a group of investors, including the TUC's staff pension fund and five other TU pension funds, as well as a number of other voluntary sector investors.

You can find out more about the campaign and how to get involved – either as an individual investor or through your pension fund – and download an investor briefing and other resources from **www.fairpensions.org.uk/justpay/about**

TUC news in brief

The TUC has responded to a number of key consultations, including

- the DWP consultation on the impact of using CPI as the measure of price increases on private sector occupational pension schemes
- TPR's consultation on enabling good member outcomes in DC schemes
- the Work and Pensions Select Committee on the Government's Pensions Reforms
- DWP consultation on regulatory differences between occupational and workplace personal pensions
- The NAPF Workplace Retirement Income Commission.

You can find the TUC evidence on the website, or contact Jennifer Mann for a copy.

Responsible investment and fiduciary duty

Fair Pensions has issued a new report *Protecting our Best Interests: Rediscovering Fiduciary Duty* which calls for "an enlightened fiduciary model" for institutional investors, to parallel the new duties of company directors introduced in 2006. The report argues that such a provision would provide a valuable "nudge towards sustainable, long term investment to overcome the narrow interpretation of fiduciary obligation which emphasise profit maximization at the exclusion of all other factors, including financial systems stability". The executive summary comments that: "Prevailing interpretations of fiduciary duty have tended to subsume the duty of loyalty into the duty of prudence, leading to a neglect of the need to avoid conflicts of interest, particularly as regards the chain of investment agents who make key decisions on behalf of trustees.

Moreover, the duty of prudence in itself may not be serving the best interests of beneficiaries: the "ordinary prudent man" standard is in danger of becoming a "duty to herd", leading to an unhelpful focus on short-term, benchmark-relevant strategies and making the industry slow to adapt."

Whilst there is increasing recognition of the need to consider environmental, social and governance (ESG) issues with the potential to affect financial returns, "there is a mis-match between the long-term benefits of better ESG risk management and the shorter-term performance benchmarks against which most asset managers are assessed". The report accepts that the extent to which trustees can or should take issues other than financial returns into account is unclear, and recommends legal clarification of this point.

Speaking at the launch of the report, Employment Minister Ed Davey, said "Fiduciary duty is the foundation of our capital markets. It is in need of repair. This report surveys the flaws and the work to be done. The report deserves to be widely read and the questions it poses deserve carefully considered response… As a government, we do want to see ESG issues considered in a rounded way in order to encourage responsible investment decisions... Fiduciary duties placed on pension fund trustees can be about more than maximising the bottom line. These duties require pension fund trustees to consider the best interests of the scheme beneficiaries and we want everyone to understand that."

"Moreover, the duty of prudence in itself may not be serving the best interests of beneficiaries"

The full report, together with an executive summary and summary of recommendations can be found at **www.fairpensions.org.uk**

Preparing for the **2012 reforms**

Two key legal changes come into effect in 2012.

a) Contracting out

New National Insurance rebates will come into effect in April 2012, so that contracting out for a DB scheme from the State 2nd Pension will become more expensive for employers and scheme members. The member rebate will reduce to 1.4 per cent from the current 1.6 per cent, and the employer rate to 3.4 per cent from 3.7 per cent.

Contracting out through a DC pension will end in April 2012. Any scheme that is contracted out on a money purchase basis will have their contracted-out certificates cancelled; references to "protected rights" will be deleted from pensions legislation, with protected rights essentially becoming ordinary money purchase rights. The disclosure rules will be amended to require trustees of affected schemes to inform their members of the changes, and transfer regulations will be amended to prescribe the conditions for allowing a transfer of COSR benefits to a DC scheme.

b) Auto enrolment

The duty on employers to auto-enrol workers into a workplace pension scheme will come into effect in October 2012. The duty is being "staged" by employer size, starting with those with 120,000 or more employees, but all employers with 250 or more employees will have a staging date before March 2014. The Pensions Regulator, which has a duty to enforce compliance, has started a programme of writing to the employers concerned. The Regulator has also issued a checklist that provides trustees with an overview of what they might need to do to ensure that their scheme is ready to be used for automatic enrolment. Trustees need to know their employer's staging date so they can assess what impact automatic enrolment will have, put in place a timetable for implementing any changes, and consider how to communicate these changes to scheme members. The checklist includes reminders of the governance, communications and administration issues that will arise for an occupational scheme used for auto-enrolment.

According to a Punter Southall survey, 75 per cent of companies intend to use their existing scheme to comply with employer duties, while 13 per cent aim to use the NEST as part of their future provision. Only 30 per cent of respondents expected their existing scheme to be compliant with the auto-enrolment minimum and 64 per cent of companies anticipated the need to review their scheme in light of the proposals – an increase from 53 per cent last year. This suggests that preparing their schemes for auto-enrolment (including the duties to regularly re-enrol workers who opt out) may become a major issue for trustees over the next 18 months.

DC investment strategy

NEST's recently published Statement of Investment Principles (SIP) is likely to become regarded as a best practice benchmark for DC schemes. The SIP includes a section on responsible investment which sets out the NEST Trustee's belief that in order to fulfil its duty to act responsibly with regards to the assets it owns on behalf of NEST members, "it must act as a responsible and vigilant asset owner and market participant. As part of this duty the Trustee integrates the consideration of environmental, social and governance (ESG) issues across all asset classes and markets in which it invests. In particular the Trustee, or its agents on its behalf, exercises its ownership rights, including voting and engagement rights, in order to safeguard sustainable returns in the long term…. NEST Corporation's Executive Team will provide quarterly reports… as to engagement activities over the previous quarter and planned engagement and voting activity in the future. The operation of NEST's voting and engagement process will be …. assessed and planned based on quantitative and qualitative data drawn from independent external providers." NEST will become a signatory of the UN Principles of Responsible Investment (UN PRI), which is a set of best-practice principles on responsible investment, and of the FRC Stewardship Code.

The Trustee also "aims to achieve compliance with best practice in its approach to investment communication, reporting and transparency", in order to promote scheme member confidence in saving, and provide clear information for the pensions industry on the Trustee's investment approach.
In addition to its target date default funds, NEST will offer an Ethical fund option and a Sharia fund.

UKSIF has called for employers to use NEST's responsible investment approach as a benchmark when selecting DC pensions for their staff. Penny Shepherd, UKSIF Chief Executive said: "NEST's approach to long-term responsible investment and ownership offers a practical benchmark particularly for less engaged or knowledgeable employers. The Pensions Regulator should encourage all employers to include modern responsible investment approaches in their pension provision." NEST's announcement on its investment approach is available at **www.nestpensions.org.uk/investment-approach.aspx**

In another key development, the DWP has published good practice guidance for the operation of default funds in DC arrangement (any scheme used for auto-enrolment must have a default fund for members who do not wish to make their own investment decision). The guidance covers a range of issues including assessing the suitability of the default option, investment performance management; and member communications. The preface makes clear that if the guidance is not followed voluntarily, the Government will consider regulations to enforce it. The guidance for occupational schemes includes a reminder that the trustees have the overall and ongoing legal responsibility for the administration, management and investment decisions within that pension scheme, and although they can delegate functions, there should be clearly documented terms of reference and reporting processes; trustees still retain overall legal

"the DWP has published good practice guidance for the operation of default funds in DC arrangement ... the guidance covers a range of issues"

responsibility even when a function has been delegated to a designated party. The default option should be designed with the likely membership profile in mind and should have a clear objective, and be appropriately and competitively priced for active and deferred members. Risks should be managed through the appropriate and diversified allocation of assets. The default option should be reviewed at least every three years, with the membership profile in mind. A review should be carried out sooner in the light of events such as consistent overperformance or underperformance of the underlying funds used in the investment strategy; significant change of employer structure

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European Directive Review

A review of the EU's main legislation on pensions, known as the IORP Directive, is expected later this year; a call for evidence has been issued by the European Commission. It is likely that the review will include re-consideration of the solvency regime that should be applied to pension funds, though it appears that the difference between pension funds and insurance companies in this respect has now been acknowledged.

The call for advice also raises the prospect of EU intervention in DC schemes especially in relation to how risks to members could be addressed.

The TUC, CBI and NAPF had a joint letter in the FT on 7th March expressing concerns about the potential for the extension of Solvency II type requirements to DB schemes.

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or member demographic (for example, an acquisition or a merger); or significant changes in the financial markets or economy. The performance of the funds within the default option should also be checked informally at regular intervals throughout the year. Any changes – or a decision not to make any changes – should be fully documented and information should be available to members.

The guidance can be obtained from the DWP website at **www.dwp.gov.uk/docs/def-opt-guid.pdf**

The Regulator's new Corporate Plan

Although much of the Regulator's attention at present seems to be devoted to its new duties in respect of auto-enrolment (see page…) it has also issued a number of other documents.

The Regulator's fifth Corporate Plan sets out how it will help employers prepare for automatic enrolment, improve standards in the defined contribution (DC) market, and address funding challenges within different segments of the defined benefit (DB) landscape.

The fourth analysis of recovery plan submissions has also been published. Some key findings are:

- The degree of outperformance allowed for in setting technical provisions has continued to increase.
- The assumptions used for future life expectancies have increased.
- Recovery plans have been getting longer with increased back-end loading, reflecting the worsening economic climate over the period being assessed. The average (unweighted) length of recovery plans increased to 9.4 years in tranche four, from 8.4 years in tranche three (the third recovery plan period) and 7.3 years in tranche two.
- A higher proportion of schemes triggered TPR's scrutiny in tranche four compared with the previous valuation period (81 compared with 62 per cent).

The Pensions Regulator has reported on standards of governance and administration in occupational schemes in its fifth governance survey. Not surprisingly, it finds that small schemes are less confident in their governance than larger schemes, and that 40 per cent of DC schemes think their overall governance is very

"The assumptions used for future life expectancies have increased"

effective compared with 65 per cent of DB schemes. Almost three quarters of trustee boards are now aware of the Regulator's focus on administration and data issues, and 91 per cent are aware of the Toolkit. Communication to members remains a key area for potential improvement – just 28% strongly agreed that trustee boards ensure a high standard of member communications and 14% disagreed .

June Mulroy, executive director for DC, governance and administration, said: "It is encouraging to see that awareness of our record-keeping guidance has improved, especially in light of our education drive earlier this year. As we have highlighted previously, levels of governance and understanding tend to be lower in smaller DC schemes. Good governance is particularly important given the risks that members carry in DC schemes such as investment performance, value for money and converting their pension pot into an income."

Jeff Moore/Empics Entertainment

Hutton's proposals for **public sector schemes**

The headline recommendation of the Hutton report is that new career average revalued earnings (CARE) schemes should be developed for general use in the public service schemes. Current members should be moved to the new schemes but with accrued rights protected, including maintaining the final salary link for past service for current members. The new CARE schemes should be indexed in line with earnings for active members and in line with price inflation for pensioners.

Hutton says that higher earners should be members of the same schemes as lower earners rather than other scheme design options such as DC top-ups over a certain level of earnings. However, he does argue that contributions should be tiered so that higher earners pay into the schemes at a higher rate. The report does not make specific recommendations on accrual rates or actual contribution rates, which are left for the Government to determine.

The report proposes that the Government should establish a 'cost ceiling' for public service pensions based on a proportion of pensionable paybill. In addition, it recommends that the Government should introduce arrangements to keep the cost below this ceiling, including default stabilisers to do this if a negotiated agreement cannot be reached.

The report finds that public service pensions should provide adequate levels of income in retirement, as defined by the Turner Commission benchmark replacement rates. The rates identified by Turner were staggered according to income before retirement, ranging from 50 per cent of income before retirement for those earning over £50,000p.a. to 80 per cent for those earning under £9,500p.a. The report says that the Turner benchmark rates should be a minimum level. It also links adequacy to participation rates, saying: "It is important that the future structure of public service pension schemes maintains or improves the participation rates of employees, especially below median earner income levels. Important considerations that will affect participation rates in the future are the level of employee contributions required, the trust that scheme members have in the scheme and the ease with which members are able to understand the scheme."

The report recommends that the Normal Pension Age for future accrual should be increased so it is in line with the State Pension Age (or to 60 for the uniformed services).

The report calls for more robust governance arrangements for all the public service schemes including the establishment of "a properly constituted, trained and competent Pension Board, with member nominees, responsible for meeting good standards of governance…" These should be established for every Scheme and LGPS Fund, according to the report. Hutton also calls for greater administrative consistency in all schemes but does not recommend the merger of LGPS funds, instead calling for more cooperation and collaboration between funds.

"The report finds public service pensions should provide adequate levels of income in retirement"

Ombudsman in action

In a recent case (*Halford*, 81134/1, reported in Hymans Robertson's *Current Issues*) the Pensions Ombudsman has censured an LGPS administering authority for failing to provide information.

The Disclosure Regulations require the trustees or scheme managers to provide information to members about any changes made to scheme benefits. The complaint was made by a deceased member's co-habiting partner, who argued that the administering authority had failed to inform his partner of a change to the scheme's provisions that entitled co-habiting partners to a dependant's pension if the member made a declaration naming them; and that, had she been informed of the change, she would have taken the action required to entitle him to a survivor's pension.

Information about the change had been included in employees' payslips, but the member in question was no longer receiving payslips as she was on long-term sick leave. The benefit statements sent to members (which the member received) also referred to the change, stating that dependant's pensions had become available to nominated co-habiting partners and that information on who qualified and what action needed to be taken would be provided later. The authority also communicated the change to members in other ways, including via its intranet. The administering authority argued that the benefit statement complied with the statutory requirement and that it had taken reasonable steps to inform all members of the change.

"reasonable efforts are not enough"

The Ombudsman upheld the complaint against the administering authority, saying that it had breached its statutory duty to notify the member about the change to dependants' pensions. The notice in the benefit statement that further information was to follow did not meet the statutory requirement, and nor did the material on the intranet, as at that time the legislation did not allow for electronic notification. The Ombudsman noted that "the statutory obligation is not to make reasonable efforts to provide the information, it is to actually provide it". The Ombudsman felt that the member would have made the required declaration had she been informed of the changes.

The Ombudsman directed the administering authority to pay the partner a pension equivalent to the dependant's pension to which he would have been entitled had the member made a declaration naming him.

Hymans commented "In the eyes of the Ombudsman, it seems, reasonable efforts to comply with the disclosure requirements are not enough. Scheme trustees and managers should review their policies for informing members (in particular deferred and pensioner members) of benefit changes, to ensure that they are fully complying with the statutory requirements."

Death benefit payments – Ombudsman acts

The Pensions Ombudsman has recently published its annual report for 2010/11. Ill-health retirement cases continue to be the single most frequent cause of complaint to the Ombudsman, with transfers a close second. Death benefits also continue to be a cause of complaint, with one case highlighted in the report as a reminder that such benefits must be made in compliance with the scheme rules:

"Mr M was a member of the Reserved Forces Pension Scheme from mid 2007 until his death in Afghanistan towards the end of that year. He did not make any nomination to say who should receive any benefit from the scheme in the event of his death but he had made a will several months before his death naming his father as his sole beneficiary. The scheme paid the death benefit lump sum to the late Mr M's girlfriend on the basis that she was a "surviving adult dependent" as defined in the scheme's rules. Mr M's father complained essentially on the grounds that the relationship with his son was not such that she should have received the benefit in preference to him. However, the Ombudsman concluded that the decision maker had misconstrued the relevant rules. On close investigation, the late Mr M's girlfriend did not qualify as a person to whom the death benefit lump sum could be paid at all. She could only have been a potential recipient of the lump sum if Mr M had completed the necessary two years' service in the scheme to qualify her for a dependant's pension. The Ombudsman directed that the lump sum payment should be made to the late Mr M's Estate, with interest. He also directed that a sum of £500 should be paid to Mr M's father as compensation for distress and inconvenience."