TUC

trustee network

member trustee news

Summer 2012

Contents

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Incentive exercises

The Pensions Regulator has replaced its 2010 guidance on incentive exercises with a short principles-based statement; this follows the publication in June of a voluntary code of practice produced by a pensions industry working group.

The Regulator's five principles are:

- An offer should be made in a clear, fair and not misleading way, to enable members to understand the implications and make decisions that are right for them.
- The offer should be open and transparent, so that all parties involved in the process are made aware of the reasons for the exercise and the interests of the other parties.
- Conflicts of interest should be identified and appropriately managed in a transparent manner and, where necessary, removed.
- Trustees should be consulted and engaged from the start of the process, with any concerns arising through the exercise alleviated before progressing.
- Fully independent and impartial financial advice should be made accessible to all members and promoted in the strongest possible terms. In almost all circumstances, the structure of the offer should require that members take financial advice.

Whilst the industry code does not cover in detail the role of trustees, the Regulator's guidance emphasises their role. It remains the Regulator's view that trustees should approach

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Welcome to the summer edition of TUC member trustee news

Another step towards auto-enrolment has now been put in place, with new legal duties preventing employers from inducing workers to opt out of pension schemes coming into force at the beginning of July. State pension reform, however, which is essential to underpinning workplace pension reform, has been pushed back, with further proposals not now expected until the autumn. A DWP spokesman has blamed the complexity of the current system and emphasized the need to get details of the reform right.

In the DB world, the Pensions Regulator's statement, "Pension scheme funding in the current environment", has in general been welcomed, if somewhat cautiously. Employers and trustees will undoubtedly be able to find within it points which support their respective views on deficit recovery plans. But the key message is clear: trustees should continue to focus on the long-term financial health of their scheme and, where there is a deficit, to seek payments from the employer which are affordable, and which treat the scheme equitably with other cash demands on the employer. There is no change in the Regulator's position that technical provisions should be based on prudent assumptions, taking into account an assessment of the employer covenant. The statement, available on the TPR website, has been thoroughly analysed by all the usual commentators; all DB trustees will want to ensure they have read the statement and considered how it applies to the circumstances of their own scheme.

On DC, it's ironic, and worrying, that at the same time as governance issues (whether on stewardship, record keeping or charges) achieve ever higher prominence, the latest statistics from the Office for National Statistics show that the number of people saving in a workplace contract-based DC pension scheme has overtaken the number saving in a trust-based DC scheme: 8.8 per cent of the private sector workforce are now in a contract-based DC pension – up from 8.6 per cent last year – while 8.7 per cent are now in a trust-based scheme, a fall of 0.2 per cent in a year. Whilst not all trust-based schemes are run as well as they could be, contract-based schemes generally lack any structure to provide governance and look after member interests. There is an opportunity here for unions to push for workplace governance committees to monitor and review the performance and administration of contract-based DC schemes, to try to fill at least part of the governance gap that usually prevails.

Governance committee members, as well as trustees, will find plenty of interest, as always, at this year's TUC Trustee Conference taking place in London on 27 November – see the back page for further details.

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such exercises with caution and presume that they will not be in most members' interests. This will involve taking advice, where necessary, and acting in accordance with their legal obligations to scheme members.

TPR chief executive Bill Galvin said: "The regulator welcomes the industry's bid to drive up standards. This is important because any transfer out of a defined benefit scheme poses a significant risk to members who may not be equipped to make an informed decision, and such offers won't be in most members' best interests. For those employers that decide to undertake such an exercise, the industry code sets out the good practice principles that should be applied. If conflicts are appropriately managed, trustees are engaged throughout the exercises, and the principles in the industry code are followed, then exercises should fulfil and be consistent with our principles."

The voluntary Code of Practice for Incentive Exercises, (available at www.incentiveexercises.org.uk), covers both Enhanced Transfer Value (ETV) exercises (where members transfer their rights from a DB to a DC arrangement, with an enhancement to the transfer value); and Pensions Increase Exchange exercises, where members of a DB scheme are offered an enhancement to their pension income (or

» The regulator welcomes the industry's bid to drive up standards. «

another inducement) in return for surrendering all or part of future (non-statutory) pension increases. It only applies to special exercises, not to options ordinarily available to scheme members.

There will be a monitoring body to assess levels of compliance with the Code; if poor practice continues, it is likely that legislation will be introduced, as the pensions minister has raised concerns about poor practice in this area. He was particularly concerned that people might make decisions that are not in their best interests, and these concerns are shared by many stakeholders across the industry. According to research published in the *Financial Times* in June, pensioners who have given up inflation-proofing on their pension in return for a higher starting level income can end up losing 40 per cent of their retirement cash.

In separate developments, the FSA has strengthened the assumptions that independent financial advisers must use when advising on a transfer to a DC scheme. The Board for Actuarial Standards is consulting on extending the scope of the Pensions Technical Actuarial Standard to involve actuarial work undertaken in connection with incentive exercises, and considering whether to require actuaries to comment on the effects of acceptance of an offer on representative members and beneficiaries.

The key points for ETVs from the Code of Practice and the new FSA guidance are:

- Members must take independent financial advice, paid for by the employer, before accepting the offer.
- 'Insistent customers' (members who take the offer against advice) are permitted to transfer, but records must be kept.
- Cash enhancements are prohibited – any company top-up must be paid into the DC scheme to fund additional pension rather than as a cash incentive to the member.
- Targeting of specific members is permitted if it ensures that offers are made only to members who can make informed decisions and understand the additional risks they are taking on.
- Independent financial advisers must more accurately reflect the cost of purchasing an annuity than used to be the case.

The key points for Pensions Increase exchange offers from the Code are that:

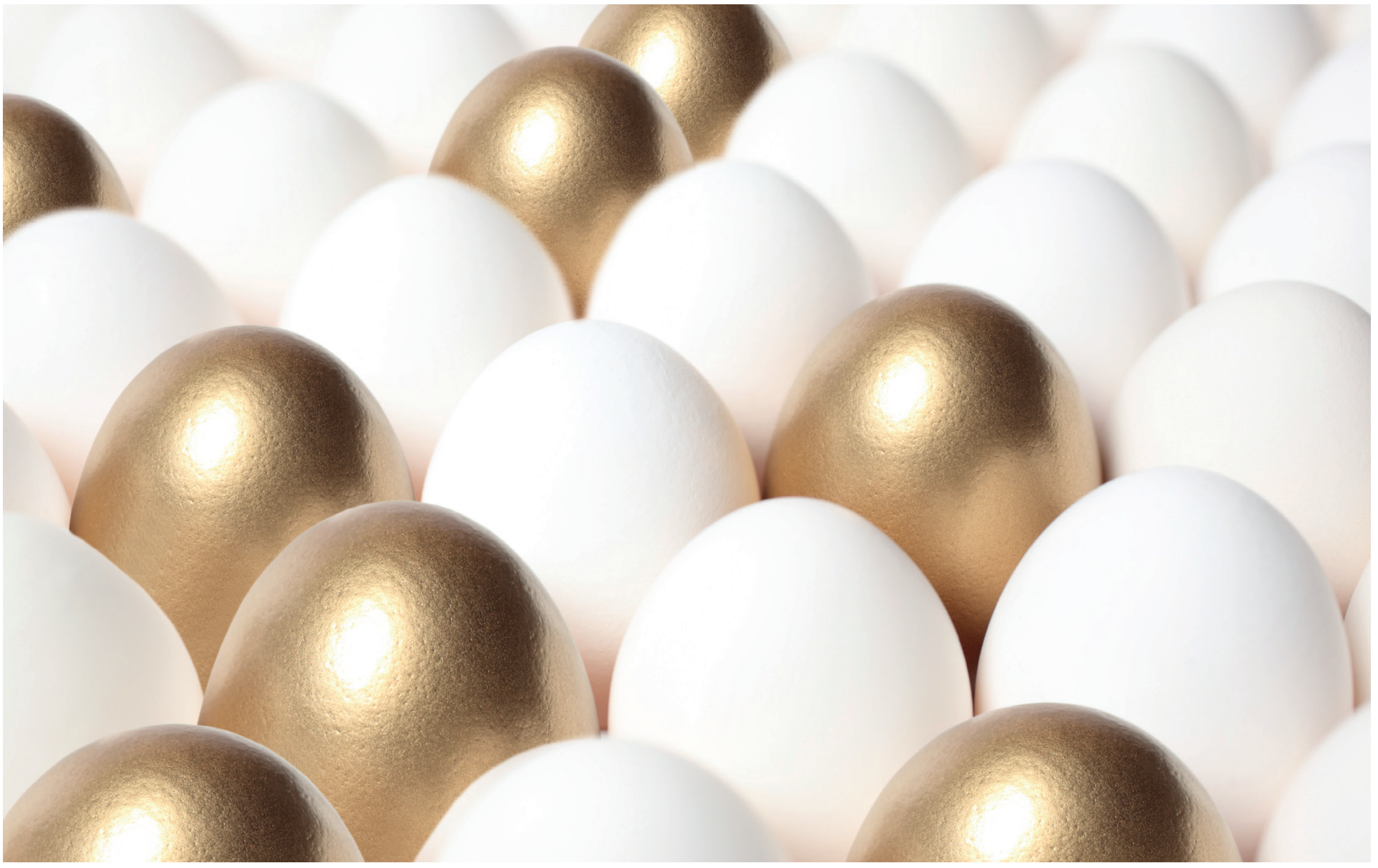
- If the value of the level pension uplift fully reflects the value of the future increases forgone (on the scheme's transfer value basis), financial guidance rather than advice needs to be provided to members (guidance does not include a recommendation on whether or not to accept the offer).
- If the value of the pension uplift is less than the value of the increases forgone, financial advice (including an adviser recommendation on whether or not to accept the offer) needs to be provided.
- Members must always take guidance before accepting the offer, and must take advice where the value test is not met unless they explicitly opt out of the advice process.
- Pensioners over the age of 80 should not be given an offer; instead they should be informed about the exercise and told that they can ask to be included.

Pension news in brief

» In a change to the consultation regulations, members must now be notified, and a consultation exercise lasting at least 60 days must be conducted, if there is a proposal to change the rate at which pensions in payment are increased or other (e.g. deferred) benefits are revalued in a way that is likely to be less generous.

» The actuarial profession has revised its guidance on how actuaries should manage conflicts of interest when advice is provided to both trustees and sponsoring employers. The revised guidance, which will not take force until 1 July 2013, will restrict the advice that can be given to sponsoring employers by the individual who is the scheme actuary and by others who advise the trustees. It will also force scheme actuaries to ensure trustees are aware of any conflicts of interest when the sponsoring employer, or another company in the same corporate group, is advised by the same firm as the trustees, even if it is by a different team of people. Scheme actuaries will be required to agree a conflict management plan where the sponsor is advised by the same firm as the trustees.

The guidance in full can be found at www.actuaries.org.uk/regulation/pages/conflicts_of_interest



NEST eight golden rules on communication

Following extensive research amongst their target market, NEST has launched its "eight golden rules" for talking about workplace pensions, particularly in the context of auto-enrolment.

The rules are:

1 Keep it real: Use examples people can relate to and avoid abstract concepts.
2 Rights not responsibility: Tell people what they're entitled to, not what they should be doing.
3 Out with the old: Make pensions relevant to their lives now and don't focus on the details of retirement.
4 One for all: Make it clear that automatic enrolment is happening to most workers, not just them.
5 Tell it like it is: Present the facts and avoid 'spin' – people want to make up their own minds.
6 Give people control (even if they don't use it): Tell people about their choices and not that everything's done for them.
7 Take people as you find them: Give people access to information that matches their knowledge and interest.
8 Be constructive: Tell people about solutions, not problems or scare stories.

There is more information about how the rules were derived, and practical examples of their use, on the NEST website (www.nestpensions.org.uk). For example, on rule 5, NEST says, "You can see this rule at work in our clear breakdowns of how charges work. It's also visible in our straightforward naming of funds. For example, we have a 'NEST Higher Risk Fund' rather than 'Higher Growth'."

About rule 3, they say, "Communications about the advantages of being in a pension scheme shouldn't focus on the details of retirement. Our research suggests that people often don't like projecting themselves into old age. The challenge is to motivate them to think about the future without concerns about growing old getting in the way. One way to do this is to discuss the future in more general terms and not focus on specific issues that may worry people. While references to the future might encourage increased saving, a focus on old age makes people uncomfortable and can prevent them from taking an initial interest in pensions."

Responsible investment round-up

Green infrastructure

A new report from UKSIF, the UK Sustainable Investment and Finance Association has found that 'green infrastructure' is emerging as an increasingly significant asset class, with opportunities driven by both regulation and changes in supply and demand. The report *The Future of Investment: Green Infrastructure,* published in June, brings together insights from leading UK infrastructure investment specialists. As well as renewable power generation, opportunities include waste and water infrastructure and social infrastructure and investors can gain exposure via real assets or companies, the report highlights.

Sustainability reporting

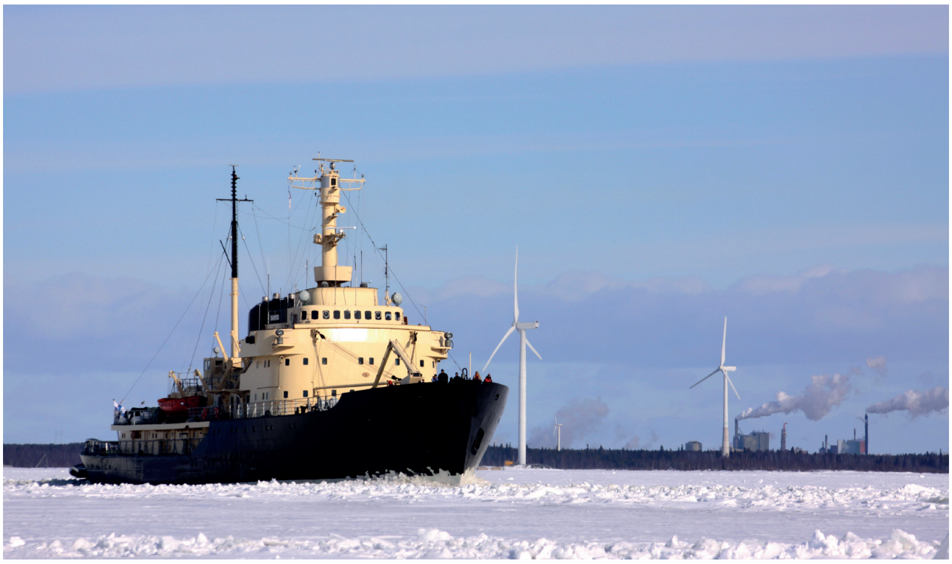
A report from Aviva Investors, *Trends in Sustainability Disclosure: Benchmarking the world's composite stock exchanges* has found that European stock exchanges continue to lead on sustainability reporting, though disclosure standards have fallen since peaking in 2008. Only 52 companies out of 4,000 surveyed engaged in 'complete' sustainability disclosure in 2010, covering the elements of energy, greenhouse gas emissions, water, waste, lost time injury rate, payroll costs and employee turnover. Aviva Investors said investors are increasingly demanding sustainability information from companies, and as the quality of this information has a clear impact on the quality of capital markets, the decline in disclosure was cause for concern. Overall, financial companies had the lowest sustainability disclosure of all industries, ranking last on five of the seven indicators; utility companies came out on top in most indicators and ranked first on disclosure around greenhouse gas emissions, water consumption, waste and employee turnover.

Good stewardship practices

UKSIF has argued that TPR must do more to promote good stewardship practices, in its response to the Financial Reporting Council's consultation Revisions to the UK Stewardship Code. "The Code needs to go further in encouraging asset owners to demand responsible stewardship practice from their service providers. The Stewardship Code can only do so much and it is therefore vital that The Pensions Regulator become involved in supporting pension funds to pursue the high-quality stewardship that is essential for long-term protection of beneficiaries' assets. More generally, the proposed changes to the Code are a 'missed opportunity' to draw out more explicitly the fact that there are environmental and social risks that can be posed to businesses and the monitoring of which plays a key part of good stewardship."

Investors and exploring the Arctic

FairPensions, together with Platform and Greenpeace, published in June a report on investor risk in Shell's Arctic exploration. Royal Dutch Shell's plans for Arctic exploration are exposing investors to a "spectrum of risks", the report warns. The report highlights Shell's failure to address key concerns for investors and environmentalists, such as its failure to test the well capping system to be used in Arctic conditions; Shell has also admitted that it has not calculated how much a large spill would cost to clean up, despite the serious financial repercussions such a spill is likely to have. The report and an accompanying investor briefing, outlining the risks investors may face and providing questions to ask Shell, are available on the FairPensions website **www.fairpensions.org.uk**



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Executive pay

Recent government proposals to tackle executive pay and address “failures in corporate governance by empowering shareholders to engage effectively with companies on pay” received a somewhat lukewarm response from the TUC and other campaigning organisations. The package includes:

- a binding vote to take place at least every three years on future pay policy (including exit payments) with a simple majority threshold, unless there are material changes to the policy or there is a majority vote against the advisory vote on the implementation of the policy
- increased transparency regarding the link between pay and performance, including the publication of a single figure.

For those who missed the TUC/FairPensions seminar in May, which dealt with executive remuneration, a briefing for trustees can be found on the FairPensions website **www.fairpensions.org.uk/sites/default/files/uploaded_files/investorresources/ExecutivePay2012.pdf**

Equity markets

The Kay review of equity markets was published just as this newsletter was going to press.

The TUC welcomed its recognition of the problems that short-termism is causing for British business and for future economic growth but warned that a voluntary approach might not achieve the necessary changes in culture and practice.

More on this in the next issue in the autumn.

Meanwhile the report can be found at **http://bit.ly/NGqccr**

DC pension charges

A study by David Pitt-Watson for the Royal Society for the Encouragement of Arts, Manufactures and Commerce (RSA) has found workers in the UK are routinely denied simple and low-cost pensions available to people across Europe. The RSA report, *Seeing Through the British Pension System,* found that 21 of the 23 pension providers surveyed failed to inform people about the charges, other than the annual management charge: audit and custodial costs, and other hidden costs including taxes, stock lending fees and broking commissions were not communicated to members. Charges accounted for up to 40 per cent of typical retirement savings.

“For markets to work effectively, consumers need to know what they are buying,” he said. “It is extraordinary that, after so many years, such a system is not in place in this country. It is vital that people have access to straightforward, accurate, high-quality information.”

The report found that in Denmark, a full clear statement is provided to pension holders. It concludes that the same could, and indeed must be made available in Britain if the pension market is to work effectively. The report also called for a ‘statement before purchase’ to be introduced which will display the likely effect that fees have on pension outcomes: “Our research shows that customers simply do not understand the pensions they are buying, because they are being badly misled about the true nature of costs and charges. Under these circumstances, markets will fail; customers will buy bad products and good pension suppliers are likely to be replaced by bad ones."

The report follows a call by Labour leader Ed Miliband for a cap on charges. Labour's statement has however been criticised by the ABI, who argued that the figures quoted were misleading: "Pension charges have been falling steadily for the last decade and are continuing to fall. In newly set up automatic enrolment schemes the average annual management charge (AMC) of our members is 0.52 per cent. The average AMC for existing schemes is 0.77 per cent. For many other existing schemes, both large and small, charges can be lower than 0.3 per cent."

The NAPF has been consulting on a draft code which would establish a framework for presenting charges to employers in a consistent way, to enable them to see how charges impact their employees' pension pots and compare charges and services between schemes. The draft Code proposes that anyone providing services or advice to employers in setting up or administering pensions will need to present employers with two pieces of information:

- a *Summary of Charges* document, which will tell employers about all the charges that the employer will pay and, separately, all the charges employees will pay
- a two-page guide that will visually illustrate the impact charges would have on a sample employee, to help employers compare schemes more easily.

In its response to the consultation, the TUC has supported the NAPF's efforts to establish a Code of Conduct on charges and argued that employers should share these documents with employees, as it is vital that workers being automatically enrolled into workplace pensions understand as fully as possible the charges that will be deducted from their contributions and/or pension fund. The TUC have also attacked the use of the term "active member discount" and argued that it should be made clear to all members if the charges will increase when they become deferred members, and argued for much greater transparency on transaction costs: "We believe that better disclosure will allow trustees, management committees and other advisors to monitor the underlying costs of investments. We see no strong reason why the charges guide cannot illustrate these costs to enable greater transparency." The TUC has also argued that the government should use its powers to limit charges on schemes that qualify for auto-enrolment.

» The NAPF has been consulting on a draft code for charges «

The Regulator included the issue of charges in the statement for DC trustees issued last October: "Trustees must understand how charging structures operate and determine what level of charges are paid by their members ... Trustees must be able to demonstrate that they have assessed and concluded that the overall charging structures offer members value for money."

However, TPR's annual report found that trustee boards' collective understanding of the annual management charge, total expense ratio and portfolio turnover rate has decreased from 44 per cent to 30 per cent over the past year. The regulator said it expected trustees to increase their understanding of charges as they are now aware of a "gap in their knowledge". The DWP has published a summary of research on pension charges, showing that on average, trust-based schemes (at 0.71 per cent) had lower AMCs than contract-based schemes (at 0.95 per cent). However, after a certain size they reach the same level (for 1,000 and more members, it is 0.48 per cent for both), providing a strong argument for scale. The report also found that 16 per cent of contract-based schemes and four per cent of trust-based schemes used active member discounts.

PQMs and lower charges

The Pension Quality Mark (PQM), which recognises DC pension schemes that have high standards of governance, communications and contributions, has revised its approach to charges. Previously, only schemes that used AMCs were able to apply for PQM. The new standard continues to require that a scheme's charges total one per cent or less for both active and deferred members, but opens the mark up to schemes that have different arrangements, such as flat-rate charges or contribution charges. To receive the PQM, such schemes will have to demonstrate that their charges are less than or equal to a one per cent AMC for scheme members on half average earnings (£13,000 a year); the intention is that this should ensure scheme charges are good value for people on lower incomes.

Small DC pots

The government has announced that, following consultation, it has opted for a "pot-follows-member" approach to dealing with small pots. Other solutions had been consulted on, including a central aggregator approach. However, announcing its decision the department said the pot-follows-member model will give "far greater levels of consolidation" and could halve the potential number of dormant pots by 2050.

An ABI survey had earlier revealed the pot follows member approach as being the preferred model among savers. However, the TUC has, in a joint statement with AgeUK and Which?, expressed strong concern at the government's proposal, arguing that there is a risk of consumer detriment if the new employer's pension scheme is worse than the old one, (for example, with higher charges or an unsuitable default investment strategy) and in any event, not every employee moves in an orderly way from job to job. Instead the groups favour the alternative 'aggregator' approach where small pots could only be automatically transferred to a limited number of high quality pension schemes which would guarantee low charges, good governance and economies of scale.

The NAPF has also expressed concern over the proposals, believing a better solution would be to allow people to transfer their pensions to large scale, good quality trust-based pension schemes. The NAPF calculated that if someone with a pension pot of £10,000 and an annual management charge (AMC) of 0.5 per cent was then moved into a pension with an AMC of 0.9 per cent, they would lose around £1,500 or 10 per cent of their pension pot after 25 years.

Teeth and toasters

Of the 68,000 calls received by The Pensions Advisory Service this year, not all were about pensions. "Particularly difficult was the call from a man whose toaster would not work," TPAS' annual report explained. "We also struggled when asked by a lady if £500 was a reasonable price for a full set of dentures, or if she might be able to get them cheaper on the NHS." However, going above and beyond the call of duty, a TPAS adviser tracked down the right section of the DirectGov website to help the lady find an NHS dentist to direct her denture dilemma to.

One gentleman rang TPAS after spotting his neighbour watering his garden during the recent hosepipe ban. When challenged, his neighbour said he was allowed to use a hosepipe because he was on pension credit. The gentleman then rang the service to check if this was true. A spokesman for TPAS said: "While there are some exemptions we are pretty sure receiving pension credit isn't one of them."

TUC Trustee Conference 2012

Tuesday 27 November, Congress House, London

Keynote speakers at this year's TUC Trustee Conference include Pensions Minister Steve Webb and Professor John Kay, author of the recent Kay Review of Equity Markets. There will, as usual, be a range of workshops for participants to choose from. You can register online at: **http://tucmembertrustee.eventbrite.co.uk**