TUC

trustee network

member trustee news

Winter 2014

Contents

2 Regulator steps up campaign against pension scams

3 TUC pensions conference

3 Welcome

4 Pension news in brief

4 Pension schemes still discriminate against same-sex couples

5 Law Commission says trustees *can* invest ethically

6 Governance Code update

7 New TUC publication calls for City reform

8 Are member trustees an endangered species?

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

Contact
Tim Sharp
020 7467 1222
trusteenetwork@tuc.org.uk

The year of four Bills

A remarkable amount of pensions legislation passed through Parliament in 2014. Three significant Acts have already been added to the statute book, and another Bill is on its way through the parliamentary process.

The Pensions Act 2014 is mainly concerned with state pensions, making provision for the new single-tier state pension from April 2016, the increase in the state pension age to 67 from 2028, and a system of periodic reviews of the state pension age. The Act also includes some measures relating to workplace pensions, including enabling provisions for automatic transfers of defined contribution (DC) pension pots on leaving employment, powers to restrict charges or impose governance requirements on DC schemes, and a number of 'tidying up' measures, in particular over auto-enrolment regulations.

The Finance Act 2014 sets out a number of transitional measures arising from the Chancellor's unexpected Budget announcements ("Changes could send pensions in wrong direction" – Summer 2014 edition of this newsletter), such as increasing the limit for trivial commutation.

Continued on page 2

Continued from page 1

The Pension Schemes Bill, introduced in Parliament in June, followed on from several years of consultation by the DWP and introduces a major, but expected, policy change: the concept of shared risk or defined ambition schemes, that have elements of both defined benefit and DC.

The Bill also paves the way for the introduction of collective defined contribution (CDC) pensions. Supporters of CDC schemes argue that the lower costs of running funds collectively will mean retirees receive larger incomes (experts have suggested up to 30 per cent more) than from an individual DC pot.

Pensions minister Steve Webb said: "This Bill will bring about new and realistic pension scheme options for those employers who want to do right by their staff."

The last of the four Bills is arguably the most radical: the Taxation of Pensions Act 2014 gives effect to changes announced in the Budget, with the stated intention of giving people "freedom and choice" over how to access their DC pension savings.

As a money Bill, it passed through Parliament more quickly than the Pension Schemes Bill, which must be approved by both Houses. Many involved with pensions are concerned that legislation that sets out what the Chancellor of the Exchequer called "the most far-reaching reform to the taxation of pensions since the regime was introduced in 1921" has received less parliamentary scrutiny than is normal for complex pensions legislation.

The Act introduces two new methods of accessing funds at retirement. But there are widespread concerns that those doing so could get hit with large tax bills, face complex annual allowance calculations if they continue to contribute or find that excessively risky or cautious investment approaches cause them to run out of money in old age.

The TUC has made its concerns clear since the March Budget, with TUC General Secretary Frances O'Grady calling the proposals rash and irresponsible.

Pension reform "should be considered and consensual, not rushed out through a bill published on the back of an envelope with an eye on next year's election," she said.

For a longer critique, see TUC Head of Communications Nigel Stanley's Touchstone blog, **http://touchstoneblog.org.uk/2014/08/what-the-chancellor-should-have-said-in-the-budget-about-pensions/**

Others are also now beginning to express in public what some in the industry called the "Flexiday" changes.

Consultancy Punter Southall said: "Whilst the policies on the single-tier state pension, on automatic transfers and on defined ambition schemes have been in development for some years, the Flexiday proposals have appeared almost at the last minute. It is not clear that these proposals fit well with existing policies: for example, are automatic transfers needed now that individuals will be able to access their multiple DC pots much more easily? Does collective DC make sense in a world where ordinary DC provides instant flexible access?"

Fabian Society General Secretary Andrew Harrop said the "revolutionary" policy unleashed by the Chancellor would leave retirements "permanently diminished". He raised concerns that DC pensions would become mere savings vehicles, and that more products were needed to help people turn their pots into long-term incomes, pointing out that:

"Before now politicians have always seen DC pensions as part of a strategic framework for retirement incomes."

Regulator steps up campaign against pension scams

The Pensions Regulator has stepped up its campaign to warn scheme members against so-called pensions liberation fraud.

Its Scorpion campaign material has been updated to reinforce the message to consumers not to be "stung" by cold calls, text message spam or website offers claiming to be able to help them cash in their pension. The regulator is urging trustees to include the leaflet in the next annual statement sent to members, and to give it to anyone who requests a transfer.

Pension scams often appear legitimate but there is a high risk that once members release their funds in this way, their money will be moved into dubious investment arrangements, often overseas and unregulated. Home visits from introducers, offers of free pension reviews, claims about legal loopholes and unusual investments such as overseas property or biofuels are all used to fool members into thinking they're being offered a legitimate pension transfer.

Members are often not properly warned that if they access their pension pot before the legal minimum age of 55, they face high tax charges and large fees.

Pensions collectivity

A TUC conference, The ABC of CDC, will be held at Congress House from 10.15am to 3.00pm on 21 January 2015.

With automatic enrolment bringing more low and middle earners into workplace pensions, attention is turning to how to improve the incomes savers can receive in retirement.

Traditional defined contribution pensions are inefficient as they leave individuals bearing investment and longevity risk alone. Legislation making its way through Parliament will allow the introduction of collective pensions in the UK.

Experts say that by pooling investment and longevity risk, Collective Defined Contribution (CDC) pensions could boost retirement savings by as much as 30 per cent.

While CDC approaches are common in the Netherlands, Denmark and Canada, this is a relatively new concept in UK pensions. This conference will explore issues including the international experience of CDC, the prospects for CDC in the UK and whether CDC pensions match what workers want for their retirement savings.

With speakers including Pensions Minister Steve Webb, Shadow Pensions Minister Gregg McClymont and a range of experts from the UK and overseas, this is an event for trustees, trade unionists and pensions and investment professionals to share information and experience.

Speakers include:

- Steve Webb MP, Minister of State for Pensions
- Gregg McClymont MP, Shadow Minister for Pensions
- Mel Duffield, Deputy Director, Pensions Policy Institute
- Chris Driessen, Policy Advisor, FNV
- Morten Nilsson, Chief Executive, Now:Pensions
- Kevin Wesbroom, Principal Consultant, Aon Hewitt
- Sandeep Maudgil, Partner, Slaughter and May
- Hilary Salt, Actuarial Director, First Actuarial
- David Pitt-Watson, Executive Fellow, London Business School
- Nigel Stanley, Head of Campaigns, TUC
- Stephen Bowles, Head of Defined Contribution, Schroders

Registration will start at 9.45am and the event will start at 10.15am sharp. The conference will include a free sandwich lunch, and be followed by tea and cakes.

The event is free, but places are strictly limited. Please register now at **http://abcofcdc.eventbrite.co.uk**

Welcome

The government has been hyperactive in the pensions sphere as our lead article explains. But it is far from clear that it has a consistent view of how pensions should develop.

One of its positive contributions is the introduction of legislation to allow collective defined contribution pensions which ensure that savings are pooled in large collective funds rather than individual accounts.

The Trades Union Congress has long argued for the introduction of CDC. Implemented well, such pensions could prove more efficient than traditional DC and allow greater sharing of investment risk during accumulation and longevity risk in the retirement stage.

The introduction of CDC is to the government's credit. However, this will just be the start of a process.

It requires more robust government action to introduce such schemes. Few will want to be the first mover in this area. However, it is cheering that, in its latest consultation paper, NEST, which stands behind auto-enrolment pensions, is looking at CDC as it reviews its approach following freedom and choice.

The many and varied issues around CDC pensions will be discussed at the TUC Pensions Conference to be held on January 21.

This free event is a great opportunity for trustees, and others interested in a trade union perspective, to discuss what will be an important topic for years to come.

PENSION NEWS IN BRIEF

Will the end to DB contracting out lead to more scheme closures?

Research conducted by Aon Hewitt on how employers intend to deal with the end of contracting out in 2016 has found that around 60 per cent of organisations that have formed a view will either cut DB accrual, or pass on the cost to their workers by reducing accrual rates or by increasing member contributions; the other 40 per cent will look to absorb the costs themselves. However, a quarter of the companies in the survey have not yet decided what to do, leaving little time to plan and implement any changes – or to consult employees.

IORP Directive will "not outlaw UK trustees" – EC

UK trustees will not be outlawed under the revised Institutions of Occupational Retirement Provisions Directive, the European Commission has said.

Speaking at a National Association of Pension Funds seminar, Saskia van Ewijk of the EC's Insurance and Occupational Pensions Unit said the Commission "understands the role trustees play in the UK system".

"The Directive is not intending to outlaw UK trustees," she added.

Concerns have been raised about the impact of the proposed requirement that someone "who effectively runs a pension scheme or has other key functions" must have adequate "professional qualifications, knowledge and experience" to carry out their key functions.

Pension schemes still discriminate against same-sex couples

A government report has found that more than one in four private sector DB schemes still provided different benefits for surviving civil partners or spouses of same-sex marriages, compared with those for opposite sex partners.

Most schemes that discriminate only provide benefits for same-sex partners based on service after 2005.

Commenting on the *Review of Survivor Benefits in Occupational Pension Schemes*, TUC General Secretary Frances O'Grady said: "It is disgraceful that some surviving civil partners and same-sex spouses are losing out on thousands of pounds of retirement income, simply because of their gender or sexual orientation.

"Thankfully, the report shows that it doesn't cost much to put right the injustice. The £400m cost to their private sector schemes is equivalent to just 0.03 per cent of pension liabilities."

Such discrimination is still legal because the same sex marriages legislation follows the pattern of the Civil Partnership Act of 2005, which provided for equal treatment from that date for surviving civil partners, but did not require any retrospective equalisation.

Most pension schemes in the private sector, including large schemes such as BT and USS, already provide equal survivor pensions.

The proportion of scheme members who will leave a surviving civil partner or same-sex spouse is very small, so the cost to schemes of full equalisation is unlikely to be material.

The government report is available from **www.gov.uk/government/publications/occupational-pension-schemes-review-of-survivor-benefits.**

A TUC guide is available at **www.tuc.org.uk/sites/default/files/Survivor%20pensions.pdf**

Law Commission says trustees *can* invest ethically

The Law Commission's report, *Fiduciary Duties of Investment Intermediaries,* makes it clear that pension fund trustees do not have to "maximise returns" in the short term at the expense of risks over the longer term.

The report arose from the 2013 Kay Review into UK Equity Markets and Long-Term Decision Making, following which the Law Commission were asked to consider how fiduciary duties currently apply to those working in financial markets, and to clarify how far those who invest on behalf of others may take account of factors such as social and environmental impact and ethical standards.

Trustees may think ethical issues are financially material. Picture by Zuma/Rex

The Law Commission said: "We conclude that trustees should take into account factors which are financially material to the performance of an investment. Where trustees think ethical or environmental, social or governance (ESG) issues are financially material they should take them into account.

"We also conclude that, whilst the pursuit of a financial return should be the predominant concern of pension trustees, the law is sufficiently flexible to allow other, subordinate, concerns to be taken into account.

"The law permits trustees to make investment decisions that are based on non-financial factors, provided that they have good reason to think that scheme members share the concern, and there is no risk of significant financial detriment to the fund."

In addition to the full report, the Law Commission have produced a short guidance note for trustees, available at **http://lawcommission.justice.gov.uk/docs/lc350_fiduciary_duties_guidance.pdf**

The trustee guidance sets out a key distinction between financial and non-financial factors. Where trustees think that aspects of a company's performance, such as poor governance, environmental degradation or a poor safety record will impact on its long-term sustainability and therefore its financial performance, they not only may but should take such issues into account in their investment decision making.

The guidance says that trustees may also take non-financial factors into consideration, in certain circumstances, and gives the following example of the difference between financial and non-financial factors:

"Withdrawing from tobacco because the risk of litigation makes it a bad long-term investment is based on a financial factor. Withdrawing from tobacco because it is wrong to be associated with a product which kills people is based on a non-financial factor." The guidance says that in general, non-financial factors may be taken into account if two tests are both met:

1. Trustees should have good reason to think that scheme members would share the concern.
2. The decision should not involve a risk of significant financial detriment to the fund.

Trustees don't necessarily need to carry out a full survey of members to determine their views, but must take care not just to assume that members share their own ethical views: they must have good reason to think that scheme members would share their concern. They must also seek advice from their financial advisers on the effect of the decision on returns to the fund, and should not proceed if the decision risks significant financial detriment to the fund.

ShareAction and the UK Sustainable Investment and Finance Association both called for statutory clarification that trustees should consider ESG factors.

Governance Code update

The Financial Reporting Council (FRC) has updated the UK Corporate Governance Code to require company boards to include "viability statements" in their strategic reports to investors.

The statements, which are expected to look forward over a longer period than just the next 12 months, are intended to "provide an improved and broader assessment of long-term solvency and liquidity".

The FRC had come under pressure from some directors to ditch the requirement, which is part of its response to the financial crisis.

The code has also been changed in relation to remuneration. Boards of listed companies will now need to ensure that executive remuneration is designed to promote the long-term success of the company and demonstrate how this is being achieved more clearly to shareholders. This replaces the former requirement for pay to be at a level sufficient to 'attract, retain and motivate' directors.

The change has been welcomed by many investors, who blamed the former requirement for ratcheting up levels of pay and for focusing on the short-term needs of management and not the interests of a company's long-term investors.

Meanwhile, FRC chairman Sir Winfried Bischoff has raised concern that pension schemes fail properly to check whether their asset managers adhere to the UK Stewardship Code.

Speaking at a NAPF seminar, Bischoff revealed that some managers were signing up to the code to get on investors' shortlists but failed to meet all its requirements. Many investors had stewardship requirements when seeking managers but they "rarely question" stewardship commitments after awarding mandates, he said. "If that's true then it's no wonder managers feel justified that they can just do the tick box." Bischoff called for more investors to sign up to the code and "challenge" their managers. "We'd like to see more asset owners making a commitment to engage with managers and apply the principles of stewardship. The more that sign up, the more we send a message to the market that stewardship is important."

» We'd like to see more asset owners making a commitment to engage with managers and apply the principles of stewardship. «

The NAPF has launched stewardship accountability forums to enable pension funds to question asset managers on their stewardship activities. The forums build on NAPF's stewardship disclosure framework and aim to promote greater transparency on the stewardship policies and activities of the asset managers who are signatories to the UK stewardship code. The forums will be open to all pension funds but may be particularly valuable for smaller schemes who do not usually have access to asset managers.

Pension fund costs

At a time when DC charges have come under greater scrutiny, a recent report from Cass Business School's Pensions Institute has found that hidden costs can account for up to 85 per cent of a fund's total transaction fees.

Pensions Institute director Professor David Blake said there are "no good reasons" that full investment management charges cannot be disclosed, as they are "genuine costs borne by the investors".

He said: "There is little point in requiring transparency where the reported measure for 'costs' does not include all of the costs, or in the short-term, as many costs as could currently be reported on an efficient basis. If total investment costs are not ultimately disclosed in full, how can there ever be an effective and meaningful cap on charges, and how can active investment managers ever assess their true value added?"

The Investment Management Association (IMA) is introducing next spring a new disclosure that requires all costs to be reported in a "comprehensive and simple pounds and pence per unit figure every year" and has work in progress to deliver similar simple transparency covering the impact of the indirect transaction costs incurred by funds.

But Blake said even the IMA's plans to report an ongoing charges figure (OCF) plus dealing costs and stamp duty paid will not include some "visible cash costs" within funds, including all commissions, taxes, fees, custodial charges and acquisition costs.

Beneath this, as much as 85 per cent of a fund's management charges are made up of hidden cash costs, which include bid-ask spread, transactions costs in underlying funds and undisclosed revenue, as well as the hidden non-cash costs of market impact, market exposure and missed trade opportunity or market timing costs.

These indirect costs are significant enough to affect the investment returns, even in passive management, Blake said.

New TUC publication calls for City reform

The TUC has published a collection of essays by authors from the City, politics, unions and academia, making the case for reforming the UK's corporate governance system, which many believe is letting down businesses and the wider economy.

The TUC book *Beyond Shareholder Value: the reasons and choices for corporate governance reform* includes 17 essays from organisations ranging from the Institute of Directors to the Fabian Society. Other authors include economist John Kay, author of last year's Kay review of equity markets.

All of the contributors agree that the current system of corporate governance is not serving the economy as well as it should and needs to be reformed. While there are a variety of proposals for how the shareholder value system needs to change, a number of themes are picked up by several authors, including:

- Shareholder value is stifling innovation and holding back investment.
- Shareholder value is closely associated with short-termism.
- It is not only shareholders that bear risks or contribute to company success.

The authors broadly agree on two themes for reforming shareholder value – changing who contributes to decision-making both within companies and wider economic institutions such as the Financial Reporting Council, and broader institutional reform to change the environment in which all companies operate. However, there are different ideas for how to carry out these reforms, with some calling for statutory worker representation on boards and others for voluntary stakeholder councils and a wider representation on regulatory bodies.

The book includes a number of proposals for institutional reform, including the introduction of different

classes of shares to differentiate between short-term traders and those with a long-term stake in a company, and tightening the rules surrounding takeovers. Reforms to company and personal taxation, such as using capital gains tax to encourage long-term share ownership, are also suggested.

TUC General Secretary Frances O'Grady said: "There is a growing consensus that we need to change our corporate governance system away from its current focus on shareholder value. It's clear that the appetite for reform is growing from across business, workers and wider society."

The book is available at **www.tuc.org.uk/sites/default/files/Beyond_Shareholder_Value.pdf**

IN BRIEF

Regulator updates Trustee Toolkit

The Trustee Toolkit e-learning programme has been through a major revamp over the summer, with four new modules on governance and investment, and a number of changes to other modules, particularly to reflect the new code of practice on scheme funding. Although it's not mandatory for trustees who have already completed the toolkit to take the new modules, TPR has reminded trustees that they have a duty to ensure their knowledge is kept current and up to date.

The Regulator has also published a quick guide on record-keeping, which sets out what the Regulator expects from trustees, and what action trustees should be taking with their administrators. This can be downloaded from **www.thepensionsregulator.gov.uk/docs/quick-guide-record-keeping-trustees.pdf**

Legal update

A High Court judge has confirmed that administrators are accountable for errors resulting from problems with automated systems.

Mr Justice Sales rejected attempts by the NHS scheme administrator to overturn a Pensions Ombudsman decision that it had been guilty of maladministration for failing to alert a member when she could retire.

Appealing the decision, the administrator claimed maladministration did not cover limitations that were inherent in a scheme administrator's automated systems. But the judge rejected this argument, saying that, although the rules of the NHS scheme were complicated, it was the job of the administrator to be "expert in understanding those rules".

Are member trustees an endangered species?

ShareAction's CEO, Catherine Howarth, has called for an urgent debate about the decline of member representation in managing pension schemes.

Member-nominated trustees (MNTs) have been performing a valuable role in pension governance for more than 20 years, since the Maxwell scandal highlighted the need for member involvement in scheme governance. But the shift from DB to DC, and growth of contract at the expense of trust-based schemes, means fewer savers participate in the governance of their own pension funds or enjoy the benefits of trustees with an interest in the scheme's success.

The role of member representatives is being sidelined because, on the basis of the DWP's latest proposals, there will be no requirement to include them on either the trustee boards of mastertrusts or the independent governance committees (IGCs) that are being introduced in contract-based pensions.

Member representatives have a huge amount to offer in pension scheme governance. Research by NEST into reasons for opting out of auto-enrolment found that 21 per cent of British consumers don't trust pension companies. When members have the right to directly elect someone to act on their behalf, it can't help but improve trust and instil confidence that money is stewarded in their best interests.

A key reason for introducing IGCs and for the new rules around mastertrust governance is to ensure alignment of interests between savers and those managing their retirement funds. Member representatives, whose own retirement security depends on the performance of their pension scheme, have incentives that are by definition aligned with other members' interests. They can also provide a valuable perspective on member communications and how well administration is working. But despite the raft of policy changes designed to engage savers with pensions and to improve outcomes for them, there has been no policy debate on the role members themselves should play in governance.

Even in DB schemes, the role of MNTs is under threat, with a trend by some employers to move to sole professional trustees. But according to BESTrustees chairman Alan Pickering, (author of the influential 2002 Pickering report), MNTs are the "unsung heroes of the pensions fiefdom". He adds: "The common sense view of an intelligent layman is a very valuable addition to the trustee debating mix. I think it would be rather sad if pensions became the sole preserve of pension experts who would be charged with design, delivery and governance."

Pickering thinks trusts have proved to be a resilient governance model. He says: "It is now recognised that you have to approach trusteeship in the way that you would approach any important governance role such as a company director. I therefore think it's rather sad there is a view out there that trustees have outlived their usefulness at the very time that we're making the model even more robust."

» The common sense view of an intelligent layman is a very valuable addition to the trustee debating mix. «