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trustee network

member trustee news

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Contents

2 Welcome

Does the fiduciary model need updating?

3 Pay: high and low

4 Open Market Option and the annuities market

5 TDR DC principles

Trustees and DC members' expectations

6 Responsible investment: NEST continues to lead by example

7 TPR asks members to warn on "early releases"

8 Trustee Toolkit refreshed

Autoenrolment update

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Does the fiduciary model need updating?

In a letter published in *The Times* in March, a group of leading investors called for legislative changes around fiduciary duties. The letter, signed by Jeannie Drake and representatives from Aviva, Hermes and PIRC among others, calls for legal clarification at a time when investors are being called upon to tackle so-called 'crony capitalism' and excessive executive pay: "If the hopes being pinned on investors are to be fulfilled, attention must turn to an aspect of the law which is pushing in precisely the wrong direction… The duty [of fiduciary shareholders] to act in the best interests of savers is widely seen as a duty to focus solely on the maximisation of short-term returns, ignoring anything that cannot immediately be monetised. The folly of such an approach has been amply demonstrated by the banking crisis."

The letter coincides with the release of a report, *The Enlightened Shareholder: Clarifying Investors' Fiduciary Duties* by FairPensions, which calls for investors' duties to the people whose money they manage to be clarified in order to overcome narrow interpretations of the law. The report claims that efforts to improve the shareholder model of corporate governance and to ensure that finance serves the real economy will only succeed

continued on page 2 >

Welcome to the spring edition

With autoenrolment starting in October, the pensions landscape will change significantly later this year as millions of workers are expected to start pension saving for the first time. On the other side of the coin, Royal Dutch Shell's announcement in January that it is to close its final salary pension scheme to new staff from 2013 marked the end of an era: it was the last of the FTSE 100 companies to offer a final salary scheme to new entrants. Across the wider economy, last year's NAPF survey found that almost a quarter (23 per cent) of pension schemes are now shut to both new staff and to future accrual, up from just three per cent in 2008.

DC schemes have many disadvantages, apart from the obvious one of transferring risk almost entirely to the member. The retirement process is far more complex than it is for DB members, and a recent study (see page 4) has found that as a result members are forfeiting thousands of pounds of retirement income. Trustees and governance committee members need to ensure they understand the issues and do all they can to help members make appropriate choices.

The Budget statement, to the relief of the industry, did not make further changes to the pensions tax (as opposed to the pensioners' tax) regime: in particular, no change was made to the current provisions for tax-free cash on retirement, and there were no major changes to the Annual Allowance. However, the decision to go ahead with reform of the state pension (and by implication the ending of DB contracting out) will impact on those schemes where DB accrual has continued. Further detail will be provided later this spring. Future increases in state pension age may also have implications for schemes where benefits are linked in any way to state pension benefits.

For members with small DC pension savings (including, for example, members who were moved from DB into a GPPP arrangement late in their working life) the new provision for funds of under £2,000 in a personal pension to be taken as cash will be a welcome improvement. This change is at least in part a result of unions raising with ministers the problems their members have encountered with "stranded pots".

Finally, please note opposite the seminar on executive pay – see you there!

Fiona Draper

the fiduciary model

> continued from page 1

if misunderstandings of the law are explicitly corrected. The report notes that the simplistic notion of a 'duty to maximise returns' leads investors to neglect factors, such as stewardship activity and environmental and social issues, which may affect their beneficiaries' prospects and their own impacts on the economy as market participants. It concludes that "there is an urgent need to reclaim fiduciary duty from the prevailing fixation on maximising short-term returns and to refocus it on sustainable wealth creation".

The report also suggests that fiduciaries should be empowered to consider the broader impacts of their investment activities on beneficiaries' future spending power or quality of life, as long as this does not compromise investment performance. "Pension investments do not exist in a vacuum, but are a means to securing a decent retirement," it argues. The report sets out detailed proposals for legislative clarification, modelled on directors' duties under the Companies Act 2006. It suggests that the Act's attempt to embed 'enlightened shareholder value' into UK company law missed a vital piece of the puzzle by not tackling the perception that fiduciary shareholders are legally obliged to be unenlightened.

More information about the report, and the full text of the letter, can be found on the FairPensions website, **www.fairpensions.org.uk**

Pay: high and low

Although executive pay has made more of the headlines recently, investors should also be concerned about low pay. A new report from the FairPay network *Face the Difference: the impact of low pay in national supermarket chains* available from **www.fairpaynetwork.org** is urging investors to put pressure on the major supermarket chains to implement a Living Wage. The Just Pay campaign, run by FairPensions and supported by the TUC and many individual unions, argues that low pay is bad for business and for the wider economy. Catherine Howarth, CEO of FairPensions, said, "With 29 per cent of low-paid people in the UK employed in the retail sector and a compelling business case for Living Wage standards, it's time that investors use their clout to persuade supermarkets to lift workers out of poverty. UK pension savers are heavily invested in the country's major supermarkets and want to see the sector achieve financial success. We have an interest as investors and as citizens in tackling the low pay problem revealed by this research. Major shareholders will be under pressure to rein in excessive executive pay in 2012 but the low pay problem in our economy deserves close attention too."

Meanwhile, Business Secretary Vince Cable's proposals to tackle excessive pay for executives have been met with some scepticism. Of the proposals on enhanced shareholder voting rights, TUC General Secretary Brendan Barber said, "While today's proposals for a binding vote on future pay for directors and for raising the level of votes required for agreement to above 50 per cent are sensible, the failure to allow workers to sit on remuneration committees means little is likely to change. People are understandably angry that while ordinary families struggle to make ends meet in a climate of falling pay and rising costs, pay and bonus payouts to senior executives seem to have been completely unaffected by the economic crisis. In recent years shareholders have spectacularly failed to rein in executive excess, and even with these extra powers at their disposal, it's unlikely that they will have the motivation or would be sufficiently critical to achieve the change that the public so clearly wants to see."

EXECUTIVE REMUNERATION – FREE SEMINAR FOR PENSION FUND TRUSTEES

Co-hosted by the TUC and Fair Pensions, 2.00–3.30pm, Monday 21 May, Congress House

Speakers:
Frances O'Grady TUC Deputy General Secretary
Catherine Howarth Chief Executive, Fair Pensions
Iain Richards Head of Governance and Responsible Investment, Threadneedle Investments

More details from Jennifer Mann on **020 7467 1222**

Open Market Option and the annuities market

A joint report by the National Association of Pension Funds (NAPF) and the Pensions Institute (PI) at Cass Business School published in February has found that around half a million people retiring each year are being short-changed by up to £1bn from their total future pension income, because overwhelming obstacles stop them getting the best deal. The £1bn loss could treble in size to £3bn over the next decade as the annuity market matures and as up to eight million people start being automatically enrolled into workplace pensions from 2012. And around 20 per cent of these losses are passed on to the public in the form of lost taxes and higher means-tested retirement benefits.

Although all DC members are entitled to shop around for their annuity (known as the Open Market Option, or OMO) the NAPF/PI report found that it is too difficult for savers to get the best deal because:

- 80 per cent of savers have pots of less than £50,000, and most annuity advisers will not find it profitable enough to advise on pots of this size.
- Fewer than one in five people have the financial know-how needed to pick the right annuity at the best price.
- Even those who know they should 'shop around' for the best rate struggle to do so because it is virtually impossible to find a specialist adviser who covers the whole market and who is willing to help those with smaller funds.
- People get too little support from employers or providers when making a decision about their annuity – often they get nothing more than a leaflet pointing them to a website with a postcode-based search engine.
- There is also a severe lack of transparency and understanding about how annuities are priced, especially for those with medical conditions who could qualify for a much higher level of pension income.

The NAPF/PI report recommends:

- People should automatically shop around for the best annuity when they retire. They should be helped to access the whole of the market, instead of only getting quotes from the insurer. A new OMO process, built into all pension schemes, would ensure that people get the best deal.
- The government should set clear baseline measures and monitor the evidence on 'shopping around' and the working of the annuity market more closely. If there is no improvement it should consider a national annuity support and brokerage service.
- Greater transparency is needed to increase competition and trust levels. The government, the FSA, and the ABI should drive transparency in annuity pricing, commission and retention business through greater disclosure.
- Employers and trustees should be able to support staff with retirement decisions without fearing legal comeback. Clearer and simpler rules need to be set for workplace advice, which could help create 'safe harbours' for employers to discuss pension matters with staff.

The report, *Treating DC Members Fairly in Retirement?* can be found on the NAPF or Pensions Institute websites **www.napf.co.uk** or **www.pensions-institute.org**.

Trustees may also wish to note that forthcoming changes to the ABI's annuity rules will prevent insurers including annuity purchase forms in their pre-retirement packs. While this is intended to encourage people to shop around rather than simply purchasing an annuity from the incumbent insurer, the requirement for members to take positive action to obtain their pension may mean they put off doing anything about it, particularly if their pot is small. Trustees may want to review the processes in place to help DC members purchase annuities when they retire.

TPR DC principles

In addition to its statement for trustees of DC schemes (covered in the winter edition of the newsletter), the Regulator has also set out six principles for good design and governance of workplace DC pension provision, which will form the basis of its regulatory approach going forward. The principles are as follows:

- **Principle 1** – Schemes are designed to be durable, fair and deliver good outcomes for members; this covers features such as the provision of a suitable default fund, transparent costs and charges and sufficient protection for members against loss of their savings.
- **Principle 2** – A comprehensive scheme governance framework is established at set-up, with clear accountabilities and responsibilities agreed and made transparent.
- **Principle 3** – Those who are accountable for scheme decisions and activity understand their duties and are fit and proper to carry them out.
- **Principle 4** – Schemes benefit from effective governance and monitoring through their full lifecycle. This includes the internal controls and monitoring needed to ensure that the scheme continues to meet its objectives, and continues to be run with the best interests of its membership in mind.
- **Principle 5** – Schemes are well-administered with timely, accurate and comprehensive processes and records.
- **Principle 6** – Communication to members is designed and delivered to ensure members are able to make informed decisions about their retirement savings. This includes all communications to members during their time with the scheme, from joining through to making decisions about retirement income, including promotion of the Open Market Option.

Principles 1 to 3 are all relevant at scheme set up, while principles 4 to 6 cover those activities that are likely to remain relevant through the life of a scheme.

Trustees and DC members' expectations

A new version of the actuarial guidance for Statutory Money Purchase Illustrations (SMPIs) for effective dates after 5 April 2012 holds out the prospect of lower projected incomes, and will need careful consideration. The Board for Actuarial Standards published the new standard for SMPIs just before Christmas. It applies to benefit statements with effective dates after 5 April 2012, but providers can continue with the old version if the statements are issued before 21 December 2012.

The key changes in the new document are:

- Providers of SMPIs (such as trustees) must take proper account of potential investment returns from the member's current and anticipated future investment strategy when setting the long-term investment assumption used in their projections, and the reasons for the preferred approach should be documented. The figure of seven per cent per annum still features in the guidance, but now as the maximum that can be used when setting the investment returns before charges.
- The annuity mortality assumptions have been updated to reflect current market practice and will be unisex to the extent of using 50/50 male/female mortality rates.

The projections resulting from the new standard may well be lower than previous years' statements, due to updated mortality assumptions, lower gilt yields and potentially lower future investment return assumptions.

Trustees will need to consider what investment return assumptions are appropriate, in the light of their members' actual investments, and also look at the wording to accompany the SMPI to try to explain to members why the projected pension may appear considerably smaller than in previous years' statements.

Responsible Investment:
NEST continues to lead by example

NEST has continued to deliver on its commitment to act as a responsible owner of assets on behalf of its members. In the last few months it has signed up to three key bodies: the UN Principles for Responsible Investment, the UK Stewardship Code, and the UK Sustainable Investment and Finance Association (UKSIF).

In signing up to the Stewardship Code, NEST has committed to exercising its voting rights and actively engaging with its investee companies. NEST says: "We firmly believe that environmental, social and governance (ESG) issues should be factored into investment processes in order to act in the best financial interests of our members. Our research points to responsible investment providing long-term value, reducing risk and contributing towards better member outcomes."

NEST has also affiliated to the UK Sustainable Investment and Finance Association (UKSIF), which introduced pension fund affiliate status last year to support occupational pension funds that do not manage investments internally to adopt more sustainable and responsible investment strategies. Other pension funds that have already signed up include the BT Pension Scheme and the Staffordshire Pension Fund. Further details on UKSIF pension fund affiliate support can be found at **www.uksif.org/members/join**

NEST has appointed The Co-operative Asset Management to provide responsible ownership services that will help NEST engage with the companies it invests in and meet its responsibilities as an active and prudent asset owner. The Co-operative Asset Management will work with Manifest, the proxy voting agency, to deliver a range of services including supporting NEST on formulating its views on environmental, social and governance (ESG) issues, including executive remuneration and boardroom diversity, water and carbon emissions and labour practices; developing processes on vote monitoring and helping NEST understand when it should move to collective action when it comes to engaging with companies.

NEST is also leading the way in simplifying communication with DC members, with the second issue of its phrasebook which encourages use of everyday terms rather than pensions jargon. For example, "annuity" becomes "retirement income" and "shopping around for retirement income" is used rather than "the open market option". NEST research has found that the jargon used by the pensions industry puts people off saving: 50 per cent of those surveyed found pensions harder to understand than other types of financial products. The new NEST phrasebook can be found on the NEST website **www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/NEST-phrasebook,PDF.pdf**

"Our research points to responsible investment providing long-term value, reducing risk and contributing towards better member outcomes."

TPR asks trustees to **warn members** on "early release"

The Pensions Regulator has urged trustees to communicate to their scheme members that they should not be taken in by website promotions, cold-calls or adverts encouraging them to transfer their existing occupational or private pension to a new arrangement in order to access a cash payment or loan. TPR says it has detected an increase in such offers, and has joined with the FSA and HMRC to warn consumers of the dangers. These schemes usually work by transferring some of the member's pension fund into highly risky or opaque investment structures, frequently based overseas – with no guarantee that members will get their money back if something goes wrong. Trustees are also urged to carry out due diligence checks before permitting pension transfers.

TPR say, "Converting a pension into cash might sound very attractive to people who urgently need money. However, if something sounds too good to be true, it invariably is."

TPR point out the downsides to early release:

- A member may be poorer in retirement: if the fund has been taken early, there will be much less (or no) income from it when they retire.
- A member may be hit by unexpectedly high fees. As part of the transaction, a member will probably have to pay the organisers a 'commission' or 'arrangement fee' and may have a number of 'deductions' made from the transfer value before they get it. Typically, the member may get around 70 per cent to 80 per cent of their transfer value once the organisers have taken their cut.
- A member may be hit with significant charges by HMRC. If a member fails to tell HMRC of the transaction, they may be charged penalties and interest in addition to the tax.

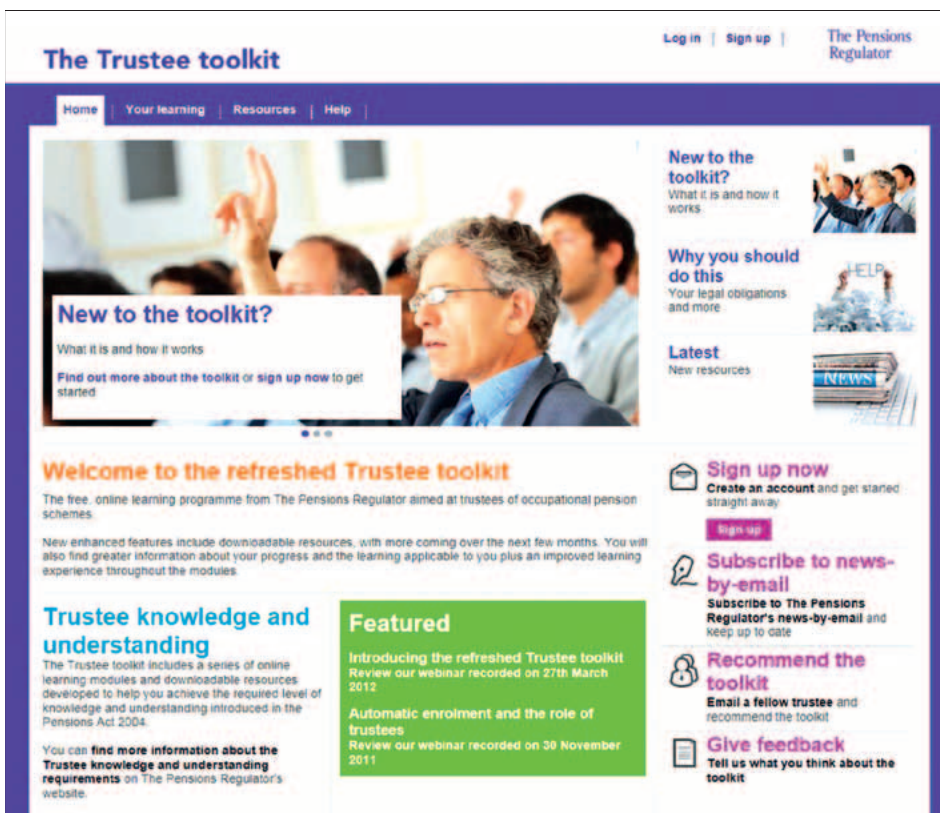
The TUC has supported the advice given by TPR. General Secretary Brendan Barber said: "Just as dodgy loan deals have been put firmly in the spotlight, the Pensions Regulator is absolutely right to warn against pension sharks too. With real wages falling and personal finances stretched it's understandable that some people might be tempted to trade their pension for short-term cash. But anyone under the age of 55 who transfers their pension into a loan could end up a big loser. Our best advice is to avoid doing so."

"Converting a pension into cash might sound very attractive to people who urgently need money. However, if something sounds too good to be true, it invariably is."

More information can be found on the TPR website **www.thepensionsregulator.gov.uk/regulate-and-enforce/pension-liberation.aspx**

Trustee Toolkit refreshed

The Pensions Regulator's e-learning programme, the Trustee Toolkit, has been refreshed and went live again in March. The toolkit is designed to provide new trustees with a free and easy way to meet the relevant trustee knowledge and understanding criteria set out in the Pensions Act 2004, as well as helping existing trustees to keep on top of their knowledge. It can also be used to give potential trustees an idea of what is involved before they put themselves forward for selection.



The Regulator's e-learning manager, Kerry Coleman said: "The Trustee Toolkit is a well respected and invaluable tool for trustees to gain the knowledge needed to run their schemes. Since the toolkit launched in 2006, e-learning technology has improved significantly. With this in mind, alongside feedback from trustees and other users, we have revamped the toolkit, made it easier to use and improved the learning process to ensure it retains a focus on customer usability." The subject matter of the toolkit has not altered but it is expected that there will be additional modules and content added in due course, reflecting changes in the pensions landscape.

The updates include downloadable resources, including PDF versions of the case studies and tutorials, to aid offline working, and more choices relating to scheme size and type when registering so that every user benefits from a more tailored programme.

Autoenrolment update

The revised timetable for auto-enrolment has been announced, and a number of other changes have been made to the regulations. Updated guidance for employers (and for trustees whose scheme is to be used for autoenrolment) can be found on the TPR website **www.thepensionsregulator.gov.uk/pensions-reform/detailed-guidance.aspx**

The guidance includes new content such as information on certification of DC schemes, the use of salary sacrifice, and updated staging information in light of the government's announcement on 25 January 2012. TPR has also produced simpler material for small employers.

The Labour Research Department (LRD) has published a practical guide on autoenrolment for union reps and members; details can be found at **1.lrd.org.uk/ukassets/images/334/Pensionsorderform2011.pdf**