TUC

trustee network

member trustee news

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Contents

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Trade unions take action

In March, the TUC and its two largest affiliated unions, Unite and UNISON, launched Trade Union Share Owners (TUSO) – a new initiative for pension investments which aims to put union values at the heart of the world of corporate governance, with a new approach to the way in which their investments are voted on at company AGMs.

From now on, at any AGM of a FTSE350 company where the TUSO group hold shares, the group will ensure that their funds take a common voting position in accordance with a new set of policy guidelines drawn up by the TUC.

TUSO will start out with over £1bn of assets, and the TUC hopes that many more of its affiliated unions will want to get involved in the coming year, as they see this new, co-ordinated approach as an effective way of getting workers' voices heard in company boardrooms. For more on TUSO and the voting and engagement guidelines it will adhere to, see the article by the TUC's Janet Williamson on page 4.

Welcome

Welcome to the Autumn edition of the TUC's trustee newsletter. You will see from our front page that it's an exciting time for the trade union movement, as unions begin to put their money where their mouth is on pension funds and responsible investment. You can read more about the new Trade Union Share Owners initiative on page 4.

It's also an exceptionally busy time for everyone connected with pensions as the Pensions Bill continues its journey through Parliament. The Bill will transform the UK's state pension system but will also have a direct impact on trustees of workplace pension schemes, as the government looks to cap scheme charges, introduce a new system of pension transfers and revise the Pensions Regulator's approach to DB funding. You can read more about the Bill on this page – and see page 8 for more on the TUC's vision for a 'third consensus' in UK pensions policy.

We are also eagerly looking forward to this year's annual trustee conference. See www.tucmembertrustee.eventbrite.com for further information.

Pensions Bill comes under scrutiny

At the time of writing the Pensions Bill is undergoing the committee stage of parliamentary scrutiny. The Bill legislates mainly for a 'single tier' state pension, merging the basic and second state pensions into a flat-rate benefit of £144 per week. There are, however, several aspects of the Bill that affect workplace pension provision.

The most significant measure arises from the discontinuation of 'contracting out', following the abolition of the state second pension. The government is proceeding with plans for a 'statutory override' for private sector employers to make changes to defined benefit accruals or contribution rates, without trustee or member consent, to recoup higher National Insurance costs arising from lost rebates. It has yet to decide on whether the override can be applied to employees with 'protected person' status arising from compulsory transfers from public sector pension schemes.

Employers can use the override multiple times, but will be required to seek certification that any changes are actuarially neutral at an aggregate level (although individual scheme members may be worse off).

Other private pensions measures include:

- ***A power to prohibit 'incentivised transfers'.*** This measure backs up the new voluntary industry code of practice, indicating the government's willingness to intervene should the code fail to protect DB scheme members.
- ***Banning 'short service refunds' within trust-based pensions.*** Currently, short service refunds are being publicised by many providers to sell trust-based DC pension scheme models on the basis that they can reduce pension contributions for employers with high-churn workforces.

- ***Plans for the 'pot follows member' system,*** the government's favoured solution to the problem of the millions of small DC pension pots that will be created once auto-enrolment is implemented. The TUC and other stakeholders remain gravely concerned that the new system creates the risk of consumer detriment if individuals' pension pots are automatically moved from a good scheme to an inferior scheme when they change jobs. The Bill does not specify when the new system will be introduced, but it is likely to apply only to new saving rather than 'legacy' schemes.
- ***An extension of the government's powers to cap charges in DC pension schemes.*** This power will be used to implement the government's decision to ban 'consultancy charging' in schemes used for auto-enrolment, which was widely welcomed by consumer representatives. The DWP also plans to consult over the summer on whether there should be a cap on charges in general.
- ***A power for the government to regulate for the creation of exceptions to employer duties on automatic enrolment.*** The power has been described as 'far too broad' by the TUC, as it potentially goes beyond the proposals to help small employers implement auto-enrolment on which the DWP consulted earlier in 2013.
- ***A new objective for the Pensions Regulator to 'minimise any adverse impact on the sustainable growth of an employer'*** of its DB funding regulation. It remains unclear how this objective will be interpreted and applied in practice, although the Regulator plans to consult later in 2013 on new guidance for trustees on DB funding in light of this change.

News in brief

A single pensions regulator

In April the Work and Pensions Select Committee published its report Improving Governance and Best Practice in Workplace Pensions. The report's recommendations included a call on the government to reassess the case for establishing a single regulatory body for workplace pensions. MPs noted concerns over current gaps in regulation, and importantly, the potential for further gaps to arise as a result of now having three regulators following the break-up of the Financial Services Authority (FSA). They were especially critical of the FSA's work in setting standards for insurers competing in the new auto-enrolment market. Other recommendations included banning both 'consultancy charging' – which the government will take forward.

True and Fair pension charges

As part of its 'true and fair' campaign, investment management company SCM Private has launched the True and Fair Calculator. The company, founded by Alan and Gina Miller, estimates that savers and investors in the UK are paying around £18.5bn per year in largely hidden costs and fees. For eighteen months the campaign has led calls for fund managers to disclose, in a single number, the total cost of all of their fees.

Now the free, online calculator allows savers to see what they are really paying for investments and how these costs have an impact on likely returns. The costs and returns are presented in one figure, in pounds and pence, and as a percentage. SCM Private believes that, in showing the relationship between cost, risk and returns – as well as allowing users to compare completely different investment or savings options side by side – the calculator offers a unique tool that will significantly improve transparency in the investment management industry.

IORPs directive

After pressure from stakeholders, including trade unions, and regulators across several states, the European Commission (EC) has suspended its plans to apply first pillar Solvency II regulations to DB pension funds as part of a revised Institution for Occupational Retirement Provision (IORP) directive. The new directive will focus instead on improving occupational scheme governance and disclosure (second and third pillars of Solvency II). The decision follows concerns raised via a separate EC initiative, that is, its green paper on long-term investment which warned of the impact of solvency requirements on funds' ability to invest for a general economic good.

VAT disappointment

The European Court of Justice has dashed hopes of a £2bn windfall for UK DB pension schemes. Deciding on a case brought by Wheels Common Investment Fund Trustees Ltd (which holds the funds for a number of Ford schemes), judges in Luxembourg ruled that the company was not exempt from paying VAT on management services provided by its advisers. This means that DB schemes will continue to pay around £100m per year in VAT, and miss out on backdated claims that could have reached £2bn. The company failed in its argument that DB funds are equivalent to the kind of collective investment vehicles that enjoy VAT exemptions – although the EU's VAT directive is currently under review.

TUSO: unions unite to vote at AGMs

Janet Williamson
TUC Senior Policy Officer

Trade Union Share Owners (TUSO), an initiative bringing together union funds to vote in line with trade union values at company AGMs, was launched in March, with the participation of the staff pension funds of the TUC, UNISON and Unite.

From now on, the pension funds of the TUC, UNISON and Unite will vote together at the AGMs of FTSE 350 companies, following a set of Trade Union Voting and Engagement Guidelines developed by the TUC (available at **www.tuc.org.uk/Trade_Union_Voting_and_Engagement**). TUSO is working with the Pension and Investment Research Consultants to turn the guidelines into actual voting recommendations at company AGMs.

The new voting and engagement guidelines have been drawn up to ensure that corporate governance policies that unions have long been critical of – for example, all-male boards, excessive director pay and bonus packages, and the non-advertisement of new director positions – will be challenged by union voting at company AGMs.

Unions have long been concerned about the growing gap between executive pay and the pay of ordinary employees in the same companies and across the economy as a whole. TUSO will vote against remuneration reports where top directors earn more than 20 times their average employee earnings and where company directors are offered pay rises that are out of line with those of their staff.

The TUC has regularly argued that incentive pay does not work and simply inflates total directors' remuneration. TUSO will vote against remuneration reports where directors' incentive pay exceeds 10 per cent of their total remuneration and will only support incentive schemes that are open to all staff on the same basis.

Currently, very few board positions are publicly advertised, which contributes to the fact that company directors are generally drawn from a narrow range of backgrounds. It is a long-standing TUC recommendation that all board positions should be publicly advertised. TUSO will vote against the Chair of the Nominations Committee unless it is clear that recruitment for board positions has involved advertising positions publicly.

The guidelines also cover a range of employment-related issues, including the paying the 'living wage' and supply chain management.

All union funds – whether pension funds or general funds – are welcome to join TUSO at any time, and indeed the initiative is open to any fund that would like its voting policies to be guided by the Trade Union Voting and Engagement Guidelines.

TUSO also provides a platform for unions to speak with one voice as shareholders. For example, TUSO has recently supported the US union International Brotherhood of Teamsters in their campaign against anti-union activity at Durham School Services, a subsidiary of National Express. TUSO attended the National Express AGM to raise concerns about the treatment of union organisers at Durham School Services and signed an Investor Statement on the issue.

If you would like any further information or would like to discuss the possibility of your pension fund joining TUSO, please contact me at **jwilliamson@tuc.org.uk**

Medical underwriting: lower cost de-risking

A recent report by the Pensions Institute at Cass Business School, authored by Dr Debbie Harrison and Professor David Blake, highlights the potential benefits of medical under-writing for bulk annuity purchases by DB pension schemes.

The DB de-risking market only emerged in 2006, but already risk transfer deals worth around £40bn had been struck by early 2012. However, this represents only three per cent of liabilities, and Harrison and Blake believe medical under-writing could enhance the attraction of annuity buy-ins for trustees. The first deals of this type were struck in late 2012 by specialist annuity provider Partnership.

Full buy-out on a section 179 basis remains the main goal for schemes looking to de-risk. But the report claims that a bulk annuity buy-in with medical under-writing, in creating a highly secure asset which accurately matches future liabilities, can make the journey towards full buy-out quicker and less costly.

Enhanced or medically under-written annuities reflect the lower life expectancy of scheme members, usually determined by obtaining relatively unobtrusive medical and lifestyle information from members. Similar products are already commonplace in the individual annuities market, as DC savers are becoming more accustomed to managing their own longevity risk when they reach retirement.

The report says small DB schemes with up to 400 members can save at least 10 per cent compared to the cost of conventional bulk annuity deals, while enhancing the security of their scheme due to insurers' solvency and capital adequacy arrangements. It also estimates the market size could quickly reach £380bn of assets under management, when it is able to cater for larger DB schemes too.

In addition, sophisticated medical under-writing could also become a core part of the conventional bulk annuity purchase market.

However, speaking at the Pensions and Benefits Show in June, LCP partner and head of buyout development Emma Watkins warned there are several things trustees need to consider before embarking on medically under-written bulk annuity deals, including:

- the need to collect medical data from scheme members – usually straightforward but sometimes of a very sensitive nature
- no turning back – once trustees have gathered medical information on members, it must be declared to any prospective annuity partner
- extended timeframes – it generally takes longer to set up bulk annuities with medical under-writing compared to conventional products
- experience – there are relatively few providers of these products, and the market remains under-developed – this applies to advisers and regulators as well as providers
- limitations – this route generally cannot be adopted for deferred members. The Cass report, *A Healthier Way to De-Risk,* is available at **www.pensions-institute.org/reports/HealthierWayToDeRisk.pdf**

The TUC's annual trustee conference, held on 26 November 2013, will feature a workshop on de-risking led by insurance broker AonHewitt. Their guide *Pension Scheme De-Risking: A Practical Guide* is available from **http://respond.aonhewitt.com/forms/UK_2012FORM-PensionDe-riskingGuide**

Local authority pension investments

As the government relaxes rules on investment in 'partnerships' by local authority pension funds, calls for larger funds and greater resources into infrastructure investment within the local government pension scheme (LGPS) have intensified.

The Department for Communities and Local Government proposed in November 2012 to increase the limit on partnership investments by local authority pension funds from 15 per cent to 30 per cent. It is this asset class through which most infrastructure investments are made. Trade unions strongly opposed the change, on the basis that partnership investments tend to be quite opaque – a higher limit increases the scope for political influence within investment decisions, especially as councillors often sit on their authority's pensions board as well as overseeing local services.

According to trade unions in local government, the main barrier to infrastructure investment is not the limit on particular asset classes, but rather the small-scale nature of most funds in the sector – something which also drives high investment costs. Analysis by Investor Data Services recently highlighted the high management fees paid by many LGPS funds.

Many funds are already becoming aware of the potential of larger-scale funds. Irrespective of the current 15 per cent limit on partnership investments, the London Pension Fund Authority (LPFA) recently joined the West Midlands and Strathclyde local authority funds in the government-supported Pensions Infrastructure Platform. LPFA has called for a merger of London's 33 funds, potentially with assets under management of £20bn.

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In the North, the Greater Manchester, West Yorkshire, South Yorkshire, Merseyside and West Midlands local authority funds have launched an 'investing for growth' initiative. Each fund will contribute an initial £50m towards pooled investments that seek to address long-term economic challenges, such as under-investment in infrastructure.

Both initiatives follow a recent report by the Smith Institute, the Centre for Local Economic Strategies, the Local Authority Pension Fund Forum, and the Pensions Investment Research Consultants, titled Local Authority Pension Funds: Investing for Growth. The report's recommendations included:

- better information and guidance on impact investment and pooled investment vehicles
- a government-sponsored 'clearing house' for data on impact investment projects around the UK – the body would be an enabling platform for assessing the social, economic and environmental value of investment opportunities.

KEEP YOUR LID ON

A recent report published by Long Finance, *Keep your lid on,* advocates an 'internal growth rate' approach to setting discount rates in DB pension funds.

The report, authored by Con Keating, Ole Settergren and Andrew Slater, argues that the current methods for setting discount rates are flawed – they usually overestimate scheme funding deficits, and introduce bias and volatility into valuations. In a mark-to-market environment, this is the case whether gilt yields, or expected rate of return on scheme assets, are used to set discount rates.

The report argues that 'smoothing' may have provided short-term relief for schemes but would not deal with the underlying flaws in fund valuations. The internal growth rate focuses instead on the value of current contributions – overlooked in present valuation approaches – contrasted with the value of the benefits to which they relate. As such this approach incorporates the entire fund design into valuations.

The report is available at **www.longfinance.net/images/PDF/Keep_your_lid_on_feb2013.pdf** and Con Keating will be presenting his views on this issue at this year's TUC trustee conference.

Responsible investment round-up

UNPRI revamped

The United Nations Principles for Responsible Investment (UNPRI) reporting framework has been revised, to focus on practices as well as principles, and incorporating an element of mandatory disclosure.

There are around 30 UK-based asset owners (mainly pension schemes) signed up to UNPRI, of whom currently only 13 disclose publicly how they comply with the principles. In the future all signatories will be required to disclose arrangements related to around 40 per cent of the framework, with the 60 per cent 'self-assessment' reporting remaining optional.

The reporting process has also been redesigned around reporting based on specific asset classes, and investment practices within schemes, rather than direct adherence to the principles themselves. It is hoped this will make reporting less arduous and more flexible for schemes.

A guide to the new framework has been issued to signatories and a data collection tool will soon be be available at **www.unpri.org/viewer/?file=wp-content/uploads/2013_PRI_RF_MayUpdate.pdf**

Sustainable investment: first international assessment

The Global Sustainable Investment Alliance has released a report on trends within the sustainable investment industry which finds that globally at least US$13.6tn worth (almost 22 per cent of the total) of professionally managed assets incorporate environmental, social and governance (ESG) concerns into their investment selection and management. The report's key findings include:

- The most common strategy used globally is negative/exclusionary screening, with US$8.3tn in assets.
- Assets utilizing ESG integration are at US$6.2tn.
- Approaches to corporate engagement and shareholder action vary greatly across regions, but this is the third-most common strategy, at US$4.7tn.

ONS data on pension scheme investments

In April the Office for National Statistics published the latest data on investments made by UK pension funds, including DB trusts, and DC pension schemes at both accumulation and decumulation stages. 2011 figures confirm the declining importance of corporate securities to pension investments – this category comprised over 70 per cent of asset holdings for most of the 1990s, but now comprises only 53 per cent.

This represents a slight rise since 2008, attributable to increased investment in mutual funds – which is becoming the preferred approach of many schemes to investing in company shares. The publication also confirms the shift towards investment in overseas corporate securities – which now comprises 43 per cent of this category, compared to 25 per cent throughout most of the 1990s.

There has also been an accelerated increase in the shift towards short-term assets, which now comprise around 17 per cent of pension fund asset holdings.

Green investments

The relationship between pension investments and climate change has been under the spotlight in recent months. In December 2012, a report released by Asset Owners Disclosure Project (AODP) argued that many of the world's biggest investors, including pension funds and insurance companies, "have their heads in the sand over climate risk". AODP commented that their research "paints a disturbing overall picture in terms of the majority failing to recognise the unique investment challenge of climate change and the dead end that the current "business as usual" represents".

Similarly, a report by the Climate Tracker Initiative (which is supported by ShareAction), in collaboration with the LSE's Grantham Research Institute, argues that institutional investors are failing to appraise risks associated with fossil fuel investments. Accordingly they "need better and more future oriented investment appraisal to determine a fair assessment on their investment risks and opportunities".

It is an issue that has now been taken up by Parliament in the form of the Environmental Audit Committee's inquiry into green finance, which will consider how pension funds can be encourage to redirect capital to investments with green objectives.

Third time lucky

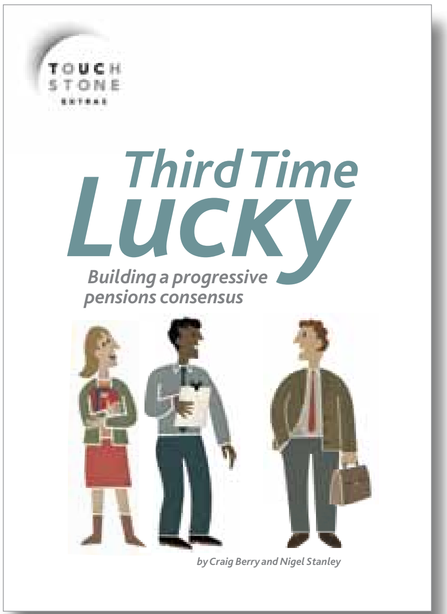
As part of the Touchstone Extra pamphlet series, the TUC recently published *Third Time Lucky: Building a Progressive Pensions Consensus,* by Craig Berry and Nigel Stanley (available at **www.tuc.org.uk/tucfiles/594.pdf**). The authors argue that there have been three periods of consensus in UK pensions policy since the Second World War.

The first consensus is what many people see as the 'golden age' of pensions provision, from the 1950s to 1970s. There was a generous contributory state pension, and many employers voluntarily shouldered many of the risks inherent in pensions saving. The pamphlet argues, however, that going back to the kind of provision we enjoyed then is neither practical nor wholly progressive, because the economic landscape has changed beyond recognition, and because the system actually produced very poor pension outcomes for certain groups, such as low-earners and women who spent time away from the labour market due to caring responsibilities.

These problems were recognised even in the heyday of the first consensus, when Barbara Castle established the state earnings-related pension scheme, essentially a state-backed DB scheme for those without good private provision.

If the first consensus was progressive for its time, the second consensus was much less so. Conservative government in the 1980s and 1990s put 'individual responsibility' at the heart of pensions provision, devaluing state pensions and allowing employers to walk away from their obligation to provide and properly fund occupational pensions.

According to Berry and Stanley, the failure of the second consensus was apparent from the start. On taking office in 1997, Labour concentrated on correcting its flaws – by strengthening the 'safety net' for the millions of pensioners at risk of poverty, and seeking to widen access to workplace pensions system scarred by mis-selling – but left its basic structures in place.



It was not until Labour's third term that a new model was sought. With cross-party support, Labour established the Pensions Commission, chaired by Adair Turner, which recommended a simpler and more accessible state pension, and 'automatic enrolment' into a workplace pension with minimum employer contributions (and a state-backed default provider offering a benchmark on cost and quality for the pensions industry).

Many of the features of the second consensus remained in the Commission's vision, such as an acceptance of the emergence of DC pensions, but the state had to do more than provide a poverty-level safety net, and actively intervene in the pensions marketplace to make it work for consumers.

The pamphlet argues therefore that the outlines of a progressive third consensus in pensions policy have been sketched. The coalition government has gone further than the Pensions Commission envisaged by proposing a 'single tier' state pension. But Berry and Stanley argue that it has not been set at a high enough level to achieve its laudable aim of providing a solid platform for private saving.

What the third consensus needs is a decent, flat-rate state pension that means people do not get less than under the current system, and lifts everybody above means-tested pensioner benefits. The government has to be more active in shaping the private pensions system: steadily increasing minimum contributions, encouraging the development of large-scale, low-cost and well-governed DC schemes, and integrating the accumulation and decumulation phases of pensions saving to reduce individuals' vulnerability to a volatile and under-performing annuities market.

The pamphlet was launched in May at the TUC seminar The Governance Gap: Improving Accountability in DC Pensions Provision, which included a keynote address by Labour's shadow pensions minister Gregg McClymont. McClymont recently published, with Andy Tarrant, the Fabian Society pamphlet *Pensions At Work, That Work: Completing the Unfinished Pensions Revolution.*

The pamphlet sets out a series of reforms that Labour believes are necessary to ensure that workplace pensions provide value for money, including transparency of costs and charges, producing larger, trust-based DC schemes to deliver lower costs and stronger governance, and lifting the restrictions on NEST. It also calls for the discrepancies between the regulatory regimes of the Pensions Regulator and the Financial Conduct Authority to be addressed. It is available at **www.fabians.org.uk/publications/pensions-at-work-that-work**