



Institute
and Faculty
of Actuaries

Future of trusteeship and governance

IFoA response to The Pensions Regulator

24 September 2019

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries (IFoA) is a royal chartered, not-for-profit, professional body. We represent and regulate over 32,000 actuaries worldwide, and oversee their education at all stages of qualification and development throughout their careers.

We strive to act in the public interest by speaking out on issues where actuaries have the expertise to provide analysis and insight on public policy issues. To fulfil the requirements of our Charter, the IFoA maintains a Public Affairs function, which represents the views of the profession to Government, policymakers, regulators and other stakeholders, in order to shape public policy.

Actuarial science is founded on mathematical and statistical techniques used in insurance, pension fund management and investment. Actuaries provide commercial, financial and prudential advice on the management of assets and liabilities, particularly over the long term, and this long term view is reflected in our approach to analysing policy developments. A rigorous examination system, programme of continuous professional development and a professional code of conduct supports high standards and reflects the significant role of the profession in society.

Mr Mark Potter
Regulatory Policy Directorate
The Pensions Regulator
Napier House
Trafalgar Place
Brighton
BN1 4DW

24 September 2019

Dear Mark,

IFoA response to TPR consultation: Future of Trusteeship and Governance

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to the Pensions Regulator's (TPR) consultation on the Future of Trusteeship and Governance. The IFoA also welcomes the drive to improve pension scheme standards of governance, which will ultimately be of benefit to scheme members.
2. We are mindful that the consultation is not in connection with actuarial matters, therefore we have limited our response to six areas where we feel our expertise and experience are particularly relevant.

Trustee Knowledge and Understanding (TKU)

3. The IFoA believes that the expectations set out in the 21st century trusteeship campaign do represent a good starting point for defining a minimum standard for trustee knowledge. It is particularly important to have the right balance and blend of knowledge and skills *across* the trustee board. Hence, we feel that it would be very difficult to successfully legislate for individual trustees to have to demonstrate a minimum level of TKU, particularly whilst maintaining the current premise that each individual trustee doesn't necessarily have to be proficient in every aspect of the role. More broadly, we do not feel that TKU should be considered in a narrow way. For example, a trustee board that is adept at involving advisers has very different TKU needs from one where they avoid involving advisers (in particular actuaries and lawyers). We therefore believe TPR should give greater prominence to 'softer' skills such as executive decision-making and oversight skills, in addition to the technical skills required of trustees.

Small and micro schemes

4. The IFoA feels that TPR should take a more proactive stance in improving standards for smaller schemes. The consultation suggests that TPR is most concerned about inadequate standards of governance in small and micro schemes, these typically being schemes which have limited budgets and/or appetites for professional advice and which may have experienced little regulatory interest or involvement. Rather than relying on industry intermediaries to support these schemes (as the consultation suggests on page 17), we feel that standards are more likely to improve if TPR directs its resources to these schemes and engages directly with them. We note that this approach has been adopted by TPR with considerable success in its work to ensure small and micro employers automatically enrol their workers. TPR could reconsider whether it could also have a beneficial impact on

governance in this sector. We also believe TPR could play a greater role in demonstrating the value of said advice to trustees to help improve decision-making, thus allowing it to focus its resources on those schemes with budgetary constraints.

Board Diversity

5. The IFoA would expect most companies, and therefore by extension their pension schemes, to have a diversity policy in place already. We agree that the diverse composition of boards can lead to improved outcomes for members and believe regulators have a role in driving this agenda forward. However, diversity is captured through existing reporting means. Furthermore, the proposal by TPR does not sufficiently recognise the need for diversity to be defined appropriately to each scheme's circumstances.
6. TPR may also wish to consider encouraging other actions, such as removing names and photos for the initial selection process for MNT elections.

Trustee decision-making

7. Fourthly, on the issue of trustee decision-making, TPR may be interested to learn that the IFoA's Actuarial Research Centre (ARC) is currently leading a research project exploring the financial decision-making of institutional investors, in particular the trustees of pension schemes, and the biases that may affect their investment decisions.
8. Three areas of decision-making research have been identified which apply to the specific setting in which trustees operate: trustees make surrogate decisions on behalf of members, they make decisions in group, and they make extensive use of external advice. We have explored the relevant adjacent research in this area in-depth in our publication in the Review of Behavioural Finance (<https://doi.org/10.1108/RBF-05-2018-0049>).
9. Despite the requirements of extensive training, and displaying higher financial literacy than a lay person, trustees are not immune from decision biases. The initial findings of the research of behavioural finance biases in trustee decision-making has found that:
 - A number of the biases tested are linked to experience: member-nominated trustees showed stronger biases than employer-nominated, with the weakest biases by professional trustees. This should be taken into account when determining the composition of trustee boards and the distribution of responsibilities to the members of the board.
 - Trustee decisions were influenced by advice and by the menu of choices provided to them. The way in which the choices are presented needs to be carefully considered so not to unduly influence the decisions of trustees towards a suboptimal alternative. In the same way, mechanisms have to be put in place to ensure that advisers setting the decision layout do not use that to their own advantage.
 - Trustees project their own preferences when choosing on behalf of members: when setting the level of pension replacement income, we found that trustees projected their own preferences instead of reflecting member preferences. This could potentially lead to higher pension contributions, higher levels of risk taking, and unsuitable asset allocation. Better communication between trustees and members is required, including a feedback loop to ensure that the decisions made by trustees are aligned to the expectations of members.

10. The research is due to be finalised later this autumn, however we would welcome the opportunity to discuss the interim findings in more detail: <https://www.actuaries.org.uk/learn-and-develop/research-and-knowledge/actuarial-research-centre-arc/research-programmes/behavioural-finance>

Sole trustees

11. We would make a general point on TPR's use of the term 'sole trustees'. The consultation implies that there is only one approach to sole trusteeship. We see many different forms and models of sole trusteeship, each with their own benefits and risks. Each scenario needs to be viewed on its merits given the diverse nature of these arrangements and would encourage TPR not to view all sole trustees through the same lens.

Solutions for schemes with guarantees

12. We note that schemes with guarantees make up a relatively small proportion of the market, therefore we would question the emphasis that TPR is placing on this issue, particularly when many of the smaller schemes concerned are unlikely to have a governance and advice budget that will enable them to seek their own bespoke solutions. Most schemes of this type have bought into a particular (usually historic) product from a provider (eg with-profits fund). We would therefore suggest that TPR considers other ways in which these schemes could be managed and improved, perhaps tackling the issue from the provider end instead of the scheme end. Whilst this is largely the remit of other regulators, we think the TPR could still help to drive conversations with providers and encourage them to find solutions, as, for example, Equitable Life has done.
13. In the absence of provider-led solutions, we are supportive of some trustee guidance about the factors to consider when winding up smaller schemes with guarantees. However, whilst we acknowledge that one issue will be the loss of trustee oversight, we note that to some extent the value of trustee oversight is already relatively weak in a scheme with guarantees, since the guarantees act to limit the options available to the trustees.

Should you wish to discuss our response in more detail, please contact the IFoA's Policy Manager Henry Thompson (Henry.Thompson@actuaries.org.uk).

Yours sincerely,



John Taylor
President, Institute and Faculty of Actuaries