16 Crucifix Lane
London, UK
SE1 3JW
+44 (0) 20 7403 7800

Amanda Latham
Regulatory Policy Directorate
The Pensions Regulator
Napier House
Trafalgar Place
Brighton
BN1 4DW

9th September 2016

Dear Ms Latham

Response to 21st Century Trusteeship and Governance paper

We would like to respond to the Pensions Regulator's *21st Century Trusteeship and Governance* discussion paper. ShareAction is a registered charity established to promote transparency and Responsible Investment ("RI") practices by pension funds and other institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 35,000 individual supporters.

We were very pleased to note some important points relating to trustee governance and training highlighted by the research carried out by the Pensions Regulator, including qualifications for professional trustees, a potential CPD framework for trustee training and issues of scale for small schemes.

1. There are currently no barriers to entry for professional trustees. Should there be? For example, should all professional trustees be required to be qualified or registered by a professional body?

We believe that professional trustees should be required to have formal qualifications and be registered by a professional body. Given the current lack of barriers to entry, it is not surprising that the Pensions Regulator's research for this discussion paper found that some professional trustees are unfit for the role. The trustee role has become increasingly technical and complex in its demands because, as acknowledged in the Pensions Regulator's 2015 *Trustee Landscape Quantitative Research*,[1] the pensions landscape is going through the greatest period of change in generations. UK defined benefit (DB) schemes face large deficits, hitting a record £1 trillion in August 2016,[2] and are under the spotlight due to difficulties faced by high profile schemes such as Tata Steel and BHS. Over three-quarters of respondents to the Towers Watson's 2016 *Future of DC survey* said that changes in governance requirements over the last five years have made the role of the fiduciary significantly more demanding.[3] Challenges for trustees also include the need to explain complex pension decisions and outcomes to members in a clear and accessible

[1] The Pensions Regulator. (October 2015). *Trustee Landscape Quantitative Research*: *A report on the 2015 Trustee Landscape research*. Available online at: http://www.thepensionsregulator.gov.uk/docs/trustee-landscape-quantitative-research-2015.pdf [accessed 9 September 2016].
[2] Hymans Robertson. (August 2016). "UK Defined Benefit deficits hit £1 trillion as the Government faces setbacks trying to buy back £60bn of gilts". Available online at: https://www.hymans.co.uk/news-and-insights/news-and-blogs/news/uk-defined-benefit deficits-hit-1-trillion/ [accessed 9 September 2016].
[3] Willis Towers Watson. (February 2016). "Is the pension governance burden finally tipping the scales?" Available online at: https://www.towerswatson.com/en-GB/Insights/Newsletters/Europe/UK-Corporate-and-Trustee-Briefing/2016/03/Is-the-pension-governance-burden-finally-tipping-the-scales [accessed 9 September 2016].

way. It is concerning that the Pensions Regulator recently had to replace three trustees in an apparent £14m fraud, under the suspicion that those trustees had misappropriated funds and exercised poor trustee governance in relation to 17 schemes.[4] Formal qualifications and professional registration should ensure that standards among professional trustees are kept consistently high and the incidence of malpractice is reduced.

However, it is crucial to take steps to ensure that introducing such a requirement does not mean that lay and member-nominated trustees (MNTs) are perceived as dispensable. As the Pensions Regulator's research shows, diversity is a key benefit of the trustee model and all types of trustees, whether lay or professional, have something valuable to bring to the running of pension schemes. We agree that it is unrealistic (and, we would add, unnecessary) to expect all trustees on the board to know all topic areas in detail, and that it is important to ensure sufficient knowledge is spread across the entire board to mitigate against risks of significant knowledge gaps or the board becoming over-reliant on a particular trustee or adviser. We believe the most appropriate model is that in the agreed IORP II text, where trustees need to be 'fit and proper' on a collective scale and have adequate professional qualifications **where applicable**. The Pensions Regulator could consider introducing a mandatory skills matrix which boards review on an annual basis to ensure that all necessary skills are present on the board and to identify where there is over-reliance on small numbers of individuals.

We understand that the Association of Professional Pension Trustees Council and the Pensions Management Institute have launched a joint consultation into the introduction of a Pension Trusteeship diploma, intended to help independent professional trustees demonstrate they are able to meet the increasing demands and challenges of 21st century trusteeship. We were pleased to see that the proposed syllabus would cover responsible ownership of assets, including:

- The extent to which social, environmental and ethical considerations are taken into account when making investment decisions;
- The corporate governance of the companies in which the trustees invest; and
- The extent to which (if at all) they will exercise their voting rights.

This is crucial, as many schemes are still failing to take financially material environmental, social and governance (ESG) issues into account, believing that they have to focus solely on short-term returns. This has enormous implications for the long-term returns that millions of pension savers will rely upon for their income in retirement. The new DC Code (*Governance and administration of occupational trust-based schemes providing money purchase benefits*) and guides issued by the Pensions Regulator are a positive step forward in highlighting that trustees should take into account ESG risks where they are financially material. However, to ensure that trustees are taking full account of the new guidance, we recommend that the Pensions Regulator take steps to ensure training on legal duties in relation to financially material ESG factors is incorporated into mandatory training programmes for professional trustees. The need for trustees to understand the financial implications of climate change and other ESG concerns is discussed in further detail in our answer to question 13.

[4] Professional Pensions. (October 2015.) "TPR removes three trustees over suspected £14m scam". Available online at: http://www.professionalpensions.com/professional-pensions/news/2430000/tpr-removes-three-trustees-over-suspected-gbp14m-scam [accessed at 9 September 2016].

2. Do you think it is the role of the chair of trustees to support trustees and use their leadership skills to improve the likelihood of appropriate scheme processes being put in place? Given the crucial role played by chairs, do you think more needs to be done to raise the standards of trustee chairmanship? For instance, do you think that chairs should be required to meet a minimum standard through having minimum qualifications or experience or belonging to a professional body?

We believe that it is the role of a chair to support trustees and use their leadership skills to improve the likelihood of appropriate scheme processes being put in place. However, we would be cautious about requiring chairs to be professional trustees or investment professionals. Specific skills are needed to be an effective chair but these exist in many walks of life. We think it would be more constructive to require chairs to undertake training that addresses the specific requirements of that role, as well as the more general demands of being a trustee, including management of group dynamics and supporting the board to ensure it has collectively attained an acceptable level of trustee knowledge and understanding (TKU).

A behavioural economist, Paul Craven, who has been working with City Noble on these issues, was quoted in a Professional Pensions article saying that the chairperson plays a key role in breaking uniformity and 'group think' on trustee boards, where a desire for harmony or conformity in a group can result in irrational decisions. He says that this is because the chair sets the tone of how the board is run; specifically: "If you [as a chair] want a good debate at a meeting it is probably good that other people do not know your views as you will influence them… It might also be good to ask the shy people to speak first as they might have a view which is valuable but they are shy about sharing it." [5]

A study sponsored by SEI's (NASDAQ: SEIC) Institutional Group, in conjunction with IFF Research and Dr Iain Clacher, Associate Professor in Accounting at Leeds University, published in January 2016, showed that many trustees of defined benefit (DB) schemes are failing to challenge their investment consultants, attributing these results to the prevalence of group think. The survey of 100 DB trustees showed one trustee always reached "their own conclusions" and 59% did not frequently consider alternatives to their consultants' recommendations.[6] This accords with the Pensions Regulator's own research, which says that "it was rare that the trustee board disagreed with its external advisors. Across all of the advisor types, the majority of schemes indicated that they rarely (58%) or never (24%) disagreed with this advisor (with 14% sometimes disagreeing and 1% always disagreeing)."[7]

Behavioural economist Professor Michelle Baddeley wrote in Transparency Task Force's online magazine, *The Transparency Times*, that "herding and other social influences have particularly distorting impacts on rational decision-making. Various experimental studies have found that a disproportionate number of people copy others' decisions… often… the group decision leads us down the wrong path, We are excessively persuaded by consensus opinions, especially when we are unsure ourselves. We might be too influenced by an

---

[5] Professional Pensions. (January 2016.) "How trustees can avoid becoming victims of group think". Available online at: http://www.professionalpensions.com/professional-pensions/feature/2443192/how-trustees-can-avoid-becoming-victims-of-group-think [accessed 9 September 2016].

[6] IFF Research and Clacher, I. (January 2016). Available online at: https://www.seic.com/enUK/about/16880.htm [accessed 9 September 2016].

[7] The Pensions Regulator. (October 2015). *Trustee Landscape Quantitative Research*: *A report on the 2015 Trustee Landscape research*. Available online at: http://www.thepensionsregulator.gov.uk/docs/trustee-landscape-quantitative-research-2015.pdf [accessed 9 September 2016].

authoritarian or seemingly authoritative member of a group".[8] MNTs can also play a crucial role in combatting this issue, and we discuss this in more detail below.

In ShareAction's research in our 2015 report, *Realigning Interests, Reducing Regulation* (RIRR),[9] we found that the Dutch system, like in Australia, the emphasis is on appointing diverse boards and ensuring their capabilities through training. The chairs of boards at insurance companies have to organise programmes of lifelong learning to maintain and improve the expertise of the rest of the board. We think it would be sensible to give chairs of schemes responsibility for ensuring training and knowledge requirements are implemented across the trustee board.

3. Should the requirement to appoint a chair and report on compliance with governance standards be introduced for DB schemes?

We believe that DB schemes should be required to appoint a chair, for the reasons given in the previous question.

4. How can we help trustees to be aware of, understand and apply the TKU framework?

We believe training for all trustees should be compulsory and completion of this training should be monitored by the Pensions Regulator. The countries examined in our RIRR report which showed best practice in pensions (Australia, the Netherlands, and Denmark), made training compulsory for all individuals with pension scheme governance responsibilities, with the regulator usually taking a facilitating role.[10] It would be difficult to argue against mandatory trustee training, given the potential saver detriment resulting from poor trustee governance, and personal liability trustees themselves may have for breaches of trust. Making it mandatory for trustees to pass all modules in the Trustee toolkit within six months of taking up their post is a sensible and proportionate way of ensuring trustees have basic levels of TKU. Trustees should also be required to complete regular training via a 'CPD framework' during the remainder of their time in the role, to ensure they are staying up to date with industry practice. The training for MNTs should be tailored to ensure that they have the confidence and ability to ask challenging questions.

In particular, we see a real need for mandatory trustee training to improve understanding of the importance of good stewardship in protecting members' outcomes, given the long-term investment horizons of many pension funds. Only 21% of trustees and pension investment professionals in a recent survey we worked to develop with Professional Pensions[11] said that environmental, social and governance (ESG) factors were fully embedded in their investment approach. 39% said they do not take ESG factors into account and are not considering doing so. Given the numerous examples of poor corporate practice on ESG having an effect on investor return – the recent example of Sports Direct being just one – it is really concerning that many trustees and fund managers still think of ESG as an optional, 'ethical' extra. As the Pensions Regulator's executive director for regulatory policy recently

[8] The Transparency Task Force, (May 2016). *The Transparency Times Launch Edition*. Available online at: https://issuu.com/andyagathangelou/docs/the_transparency_times_launch_editi [accessed 9 September 2016].
[9] de Ste Croix, C. (June 2015.) *Realigning Interests, Reducing Regulation*, p25. Available online at: http://action.shareaction.org/page/-/ReducingRegulationReport.pdf [accessed 9 September 2016].
[10] de Ste Croix, C. (June 2015.) *Realigning Interests, Reducing Regulation*, p27. Available online at: http://action.shareaction.org/page/-/ReducingRegulationReport.pdf [accessed 9 September 2016].
[11] Professional Pensions. (August 2016). *Climate change is 'overblown nonsense' and not a material risk, says industry.* Available online at: http://www.professionalpensions.com/professional-pensions/news/2468851/climate-change-is-overblown-nonsense-and-not-a-material-risk-says-industry [accessed 9 September 2016].

stated, trustees need to “wake up and smell the coffee” on ESG.[12] We have just published a report,[13] in collaboration with ClientEarth, which states that the failure of many pension funds to adequately assess and manage climate risk may leave them in breach of their legal duties to beneficiaries.

5. Do you have any views as to how we can help new trustees bring their knowledge and skills up to the required standard within the statutory period? For instance would it be useful to make completion of the Trustee toolkit or other equivalent learning tool within six months mandatory? Or would the introduction of a six-month probationary period for new trustees help to meet standards of TKU? What are the difficulties associated with these options and how could these be solved?

We believe that it would be helpful to make completion of the Trustee toolkit mandatory within six months of trustees taking up their post. This should also be completed retrospectively for existing trustees who have not yet completed the toolkit, or undertaken equivalent training sessions. We have not identified any difficulties associated with this option.

6. How can trustees demonstrate they have the minimum level of competence required to fulfil their role? For instance, do you think holding relevant qualifications is the right way to demonstrate competence? What are the difficulties associated with this option and how could these be solved? Are there other options?

We would be cautious about requiring **all** trustees to have formal qualifications, as this is likely to limit the pool of candidates and could restrict the ability of beneficiaries to be represented at board level. As the Pensions Regulator’s research shows, diversity is a key benefit of the trustee model and all types of trustees, whether lay or professional, have something valuable to bring to the running of pension schemes. This was confirmed in the research gathered for ShareAction’s RIRR report. MNTs or individuals with experience of working with them, repeatedly said in interviews that despite not being pensions or investment experts, MNTs would often ask difficult questions of providers. Several interviewees and roundtable participants said MNTs can be less reticent to ask questions that seem ‘silly’, or obvious, compared with professional trustees with a reputation to uphold. During interviews, ShareAction heard numerous examples of MNTs making a difference to outcomes, including fighting for cost savings resulting from a scheme merger to be passed onto beneficiaries; initiating the formation of subcommittees, for example on audit, investment or administration; putting contracts for professional advisors out to tender, resulting in fee savings; and acting as an approachable point of contact for other beneficiaries, who were nervous about asking questions to professional representatives of the scheme.[14]

[12] The Pensions Regulator. (September 2016). *TPR: Trustees must wake up and smell the coffee on ESG*. Available online at: http://www.professionalpensions.com/professional-pensions/news/2470190/tpr-trustees-must-wake-up-and-smell-the-coffee-on-esg [accessed 9 September 2016].

[13] ShareAction and ClientEarth. (September 2016.) *The hot debate on climate risk and pension investments: Does practice stack up against the law?* Available online at: https://shareaction.org/wp-content/uploads/2016/09/ClimateInvestmentDuties-InvestorReport.pdf [accessed 9 September 2016].

[14] de Ste Croix, C. (June 2015.) *Realigning Interests, Reducing Regulation*, p19. Available online at: http://action.shareaction.org/page/-/ReducingRegulationReport.pdf [accessed 9 September 2016].

We believe that a better option would be to make completion of the Trustee toolkit mandatory within the first six months of appointment, and require trustees to attend regular CPD training throughout the remainder of their time in the role.

7. Do you have a view as to whether a CPD framework would assist trustees to meet the challenges of scheme governance? What are the difficulties associated with this option and how could they be solved?

We believe a CPD framework would be highly beneficial in assisting trustees to meet the challenges of scheme governance. This would be particularly helpful in ensuring that trustees stay up to date with industry practice, as well as new legal requirements and best practice. It was concerning to see in the Pensions Regulator's *Trustee Landscape Quantitative Research* that while 59% kept a training log for trustees and 45% had a training plan in place, nearly a third did not have either.[15] This requirement is particularly important for smaller schemes with fewer resources, as this research also shows that only 28% of small schemes in the UK have a training plan in place for their trustees, compared with 67% of large trust-based schemes.

The Pensions Regulator's research found that lack of time was a key barrier to some trustees taking up training.[16] This is the most obvious difficulty associated with requiring trustees to complete a CPD-style framework. We commend the Pensions Regulator's work in using tailored, accessible guidance to support trustees with limited time available for their role. However, we are concerned that this will not fully alleviate the time pressure on non-professional trustees and may cause them to cut corners in terms of their standards of TKU, putting members' outcomes at risk. Interviewees in the research conducted for our RIRR report emphasised that lay trustees need to be given time off by employers for training as well as to attend board meetings. Allowing MNTs time to fulfil their duties needs to be made attractive to employers as, understandably, many may be reluctant to give workers the time off, particularly in a multi-employer pension scheme environment. However, this is not an insurmountable obstacle. We would recommend that the Government amends the Employment Rights Act 1996 so that MNTs have the same rights to request reasonable time off work to fulfil their duties as magistrates, school governors, trade unionists, beneficiaries of the Army Reserve forces and other roles prescribed in the legislation. In our research for RIRR, roundtable attendees agreed that employers could be reimbursed from the scheme for the paid hours that an MNT spends on pension scheme duties. The skills and knowledge that the employee would build up could be emphasised to the employer. Training could even be accredited by recognised bodies so that it would count towards continuing professional development requirements or points that employees in certain sectors or companies have to accrue.[17]

Another difficulty associated with introducing CPD training requirements is the cost to the scheme. In the first place, we would strongly argue that any cost to the scheme would be offset by the improved levels of trusteeship and governance that should result from implementing regular training on key issues. However, to keep costs at a reasonable level, we would recommend that either the Pensions Regulator provides compulsory online CPD training, in a similar format to the Trustee toolkit, or that smaller schemes with fewer

---

[15] The Pensions Regulator. (October 2015). *Trustee Landscape Quantitative Research*: *A report on the 2015 Trustee Landscape research*. Available online at: http://www.thepensionsregulator.gov.uk/docs/trustee-landscape-quantitative-research-2015.pdf [accessed 9 September 2016].

[16] The Pensions Regulator. (July 2016.) *21st Century Trusteeship and Governance*, p12. Available online at: http://www.thepensionsregulator.gov.uk/docs/21st-century-trusteeship-governance-discussion-2016.pdf [accessed 9 September 2016].

[17] de Ste Croix, C. (June 2015.) *Realigning Interests, Reducing Regulation*, p28. Available online at: http://action.shareaction.org/page/-/ReducingRegulationReport.pdf [accessed 9 September 2016].

resources are required to collaborate on procuring training sessions, spreading the costs across schemes.

We would note also that any desire not to burden trustees with increased learning requirements needs to be balanced against the (crucial) need to protect member outcomes.

8. What further education tools and products would you find useful to receive from us?

N/A.

9. What do you think is the best way of managing conflicts of interests? How could the system be improved to reduce the likelihood of conflicts arising in the first place?

Given that the Pensions Regulator's latest DC research suggests that not all schemes, particularly small ones, have a written policy for managing conflicts of interest or maintain a register of trustee interests,[18] it seems essential to address this as a first priority. Without a robust process for identifying and monitoring conflicts of interest, it is difficult to see how trustee boards can ensure that conflicts are managed effectively. This situation may be improved if the Trustee toolkit is made compulsory and mandatory CPD modules focus on conflict issues. However, we would also recommend that trustees should be required to submit their conflicts management policies and records to the Pensions Regulator on an annual basis, to ensure that these basic processes are being put in place.

It was concerning to note that 60% of micro DC and 48% of small DC schemes did not have procedures in place to assess the effectiveness and performance of their advisors,[19] especially in view of the Pensions Regulator's comment that "in some schemes, particularly small ones, there was no formal process [for appointment for advisors] and appointments were made based on existing personal relationships or recommendations".[20] These issues could be addressed by a mandatory consolidation of schemes, as discussed in more detail in our answers to questions 11 and 13. In the meantime, it may be useful for the Pensions Regulator to offer guidance on appropriate methods for identifying, assessing and appointing prospective advisors. For example, ShareAction has assisted the Transparency Task Force's Stewardship team with some work on a draft bank of questions for trustees to ask their advisors prior to entering into a mandate, and we would be delighted to discuss this project in more detail with the Pensions Regulator, if this is of interest.

10. What do you think are the key challenges faced by trustees in engaging effectively with administration and investment governance and third party providers and advisers? What could we do to help them in addition to what we outline above?

A key challenge faced by trustees in engaging effectively with third-party advisors is the opacity of fees and charges in the investment system. The most concerning aspect of the

---

[18] The Pensions Regulator. (July 2016.) *21st Century Trusteeship and Governance*, p14. Available online at: http://www.thepensionsregulator.gov.uk/docs/21st-century-trusteeship-governance-discussion-2016.pdf [accessed 9 September 2016].

[19] The Pensions Regulator. (July 2016.) *Defined contribution trust-based pension schemes research: A summary report on the 2016 research survey*. Available online at: http://www.thepensionsregulator.gov.uk/docs/dc-research-summary-report-2016.pdf [accessed 9 September 2016].

[20] The Pensions Regulator. (July 2016.) *21st Century Trusteeship and Governance*. Available online at: http://www.thepensionsregulator.gov.uk/docs/21st-century-trusteeship-governance-discussion-2016.pdf [accessed 9 September 2016].

Pensions Regulator's 2015 *Trustee Landscape Quantitative Research* is the statistical analysis of trustees' views on value for money, which states:

Schemes generally expressed high confidence about receiving value for money from their external advisors. Across all of the advisor types, 40% of schemes were very confident that they received value for money and a further 51% were confident.[21]

A report by the Transparency Task Force recently found more than 100 charges are routinely levied on pension savers, many of them hidden. The study suggested the number of fees levied on a pension is three times higher than previously thought, encompassing fees including bank set-up costs, tax advice fees, transaction charges and fund administration, legal, compliance and governance fees.[22]

Tom Tugendhat, the Conservative MP who asked the then Prime Minister David Cameron a parliamentary question about fund fees, said that hidden charges on investment products can "strip a third off of the gains a pension could make over a lifetime". He was later quoted in the Financial Times saying he had discovered that the total charges on his own investment portfolio were "more than five per cent a year" as a proportion of his assets, or "about triple what I had originally calculated". "The total fees included many that were not advertised," he said, "such as entry and exit charges for investment funds."[23]

It is deeply concerning that so many pension trustees are blithely unaware of the true costs underlying the services they receive from their fund managers. A small minority (3%) of schemes said that felt that they were not receiving value for money from the external advisor about whom they had been asked. Of these, some did say that this was because the market/industry overall does not offer value for money, or that they had reviewed the costs and charges and this suggests they do not offer value for money. However, others simply said that they do not have the necessary knowledge or expertise to know whether they are receiving value for money or that they had not reviewed whether they are receiving value for money.

The OECD judges the Dutch system to have the third lowest costs out of 40 countries examined.[24] The Dutch system was rated second out of selected OECD countries on Pension funds' real net rate of return on investment.[25] ShareAction's research in our RIRR report suggests that one reason for this is the culture of Dutch boards, who seem to negotiate harder on fees and charges than British ones. One interviewee in our report suggested that the particular culture of Dutch pension fund boards explains why schemes achieve amongst the lowest costs and charges in the world for their beneficiaries: 'Boards of trustees in the Netherlands generally negotiate more than they do in the UK, for example in the Netherlands pension fund boards will negotiate a lower bonus cap for their asset managers, 20% is common but in the UK the cap is more like 100% or sometimes unlimited. Some interviewees suggested that training should include negotiation skills to make sure

---

[21] The Pensions Regulator. (October 2015). *Trustee Landscape Quantitative Research*: *A report on the 2015 Trustee Landscape research*. Available online at: http://www.thepensionsregulator.gov.uk/docs/trustee-landscape-quantitative-research-2015.pdf [accessed 9 September 2016].

[22] Cumbo, J. (May 2016.) "Asset managers under fire over hidden pension fees". Financial Times. Available online at: http://www.ft.com/cms/s/0/9b82851e-1e92-11e6-a7bc-ee846770ec15.html#axzz4JOwENGZU [accessed 9 September 2016].

[23] Rovnick, N. (April 2016.) "David Cameron takes aim at fund managers' hidden charges". Financial Times. Available online at: http://www.ft.com/cms/s/0/0b1318da-0c7d-11e6-9456-444ab5211a2f.html#axzz4JOwENGZU [accessed 9 September 2016].

[24] OECD (2015.) Pensions at a Glance. Available online at: http://www.oecd-ilibrary.org/docserver/download/8115201e.pdf?expires=1473444740&id=id&accname=guest&checksum=04D2743A001A1AA6430521303771F09E [accessed 9 September 2016].

[25] OECD (2015.) Pension Markets in Focus. Available online at: http://www.oecd.org/daf/fin/private-pensions/Pension-Markets-in-Focus-2015.pdf [accessed 9 September 2016].

trustees have the confidence to challenge providers. As one interviewee said: 'The financial services people deliberately try to bamboozle outsiders, for example with jargon and abbreviations. It can be very intimidating for outsiders to walk into a room of well-dressed finance professionals... and challenge them. This is why you need people with confidence.'[26]

We have also identified certain confusion concerning the legal position where trustees delegate to their asset managers. During the course of our research for a report on the extent to which climate risk is considered in pension investments, one lawyer commented that many trustees do not have the skills to adequately track the extent to which their asset managers monitor and manage long-term risks such as climate risk. In answer to a question about how far ESG factors such as climate risk are taken into account in investments, one survey respondent said, "It is a factor in manager selection but beyond that we depend on managers for individual decisions" and another commented, "We use fund managers and get comfortable they have strong governance". However, pension fund trustees' legal duties to act in the best interests of members, to exercise "prudent" investment behaviour and to balance risks against returns cannot be wholly delegated to fund managers. Trustees must still comply with these duties when undertaking the functions that have not been delegated. The day-to-day investment decisions, such as the types of investments to hold, may be delegated to asset managers but trustees retain supervisory and overall strategic decision-making power. This normally includes determining the overall investment objectives and making strategic investment decisions, such as the risk/return profile appropriate to the membership, and the proportion of investments to hold to achieve this. Trustees also retain legal responsibility for monitoring fund managers. They will not be held responsible for the acts or defaults of asset managers so long as they have taken all reasonable steps to satisfy themselves that their asset managers: have the appropriate knowledge and experience to manage scheme investments; are carrying out their work competently; and are complying with the Investment Regulations. It is concerning that some trustees do not appears to have the skills or resources necessary to undertake these crucial aspects of their duties. It is crucial that this lack of understanding is addressed by the Pensions Regulator without delay.

11. What should be done with those schemes that are unwilling or unable to deliver good governance and member outcomes? In particular, should small schemes be encouraged or forced to exit the market or to consolidate into larger scale provision? Is regulatory intervention required to facilitate this or can it be achieved through existing market forces?

In its 2014 report, *Defined contribution workplace pension market study*, The Office of Fair Trading found that: ‘large single employer trust based schemes tend to have good scheme governance… By contrast, we have significant concerns about the governance of smaller, single employer trust based schemes. Trustees in these schemes may lack the necessary expertise and may not provide governance oversight on an ongoing basis’.[27] Regulatory intervention is required to ensure that smaller schemes are producing good outcomes for their beneficiaries. Schemes must operate at scale to ensure adequately skilled governing bodies, sufficient internal support and to access economies of scale and better bargaining power. Costs per saver can be brought down when there are more beneficiaries in a scheme to bear them.

[26] de Ste Croix, C. (June 2015.) *Realigning Interests, Reducing Regulation*, p28. Available online at: http://action.shareaction.org/page/-/ReducingRegulationReport.pdf [accessed 9 September 2016].
[27] Office of Fair Trading. (2014). *Defined contribution workplace pension market study*, (updated version). Available online at: http://webarchive.nationalarchives.gov.uk/20131101164215/http:/www.oft.gov.uk/shared_oft/market-studies/oft1505 [accessed 9 September 2016].

It could take a very long time for market consolidation to happen without regulatory intervention, particularly considering the large number of small schemes in the UK. Single employer trusts are relatively immune from the market forces which drive consolidation in the master trust sector. Additionally, as a Centre for Policy Studies report points out: 'it is naïve to expect professional trustees to be pursing scheme consolidation ("scaling up") with enthusiasm; it runs contrary to their interests. Fewer schemes means less business'.[28] The same principle applies to third-party advisors.

The clear benefits of greater scale give policymakers a strong reason to intervene in the market to ensure DC schemes are of an adequate size. Scale is a benefit for beneficiaries but also for regulators. In the course of our research for RIRR, one interviewee pointed: 'the regulator also has a limited budget, so as there are so many schemes in the UK the regulator can't oversee them all and just focuses on the biggest ones...this means that beneficiaries in small schemes through no fault of their own are much less well protected by the regulator.'[29]

The countries examined in our RIRR report (chosen due to the excellent reputation of their pension systems) all had a higher proportion of large schemes when compared with the UK. The Dutch pension regulator, for example, has been active in seeking to reduce the number of schemes in their country. It was recently announced that the number of pension funds is set to drop to 265, having fallen from more than 800 in 2005 to the current total of 325.[30] In Australia, schemes have to assess and report to the regulator annually on whether insufficient scale in terms of beneficiaries or assets means the financial interests of their beneficiaries are compromised compared to the beneficiaries of products in other schemes.[31] Therefore, small schemes that are working well are not forced to merge or transfer beneficiaries to a different scheme; but they must justify how they are overcoming the inherent disadvantages of operating at a small scale. The number of schemes fell from 5,000 in the mid-1990s to 500 by the end of 2009 and the average scheme size in Australia is 26,000 beneficiaries compared with 2,500 beneficiaries in the UK.[32]

An alternative to forcing or nudging smaller schemes to merge is to facilitate collaboration. In Denmark it is common for schemes to collaborate, for example by pooling funds for investment or jointly purchasing services from third parties.[33]

12. Would you find it useful to see overarching guidance covering issues common to all schemes, with more specific issues being covered in technical guidance?

We believe that it makes sense to have overarching guidance covering issues common to all schemes, especially given that many trustee boards oversee both types of scheme.

---

[28] Johnson, M., Put the saver first: Catalysing a savings culture'. Centre for Policy Studies, 2012, p.17. Available online at: http://www.cps.org.uk/files/reports/original/120613094539-Putthesaverfirstabridgedversion.pdf [accessed 9 September 2016].

[29] de Ste Croix, C. (June 2015.) *Realigning Interests, Reducing Regulation*, p29. Available online at: http://action.shareaction.org/page/-/ReducingRegulationReport.pdf [accessed 9 September 2016].

[30] Pressman, L. (March 2016.) *Dutch regulator expects number of pension funds to fall to 265.* IPE. Available online at https://www.ipe.com/countries/netherlands/dutch-regulator-expects-number-of-pension-funds-to-fall-to-265/10012344.fullarticle [accessed 9 September 2016].

[31] Bateman, H., 'Retirement income provision in Australia – outstanding design issues in a mature system', University of New South Wales, 2009. Available online at: http://wwwdocs.fce.unsw.edu.au/fce/Research/ResearchMicrosites/CPS/retirement.pdf [accessed 9 September 2016].

[32] *Ibid.*

[33] de Ste Croix, C. (June 2015.) *Realigning Interests, Reducing Regulation*, p29. Available online at: http://action.shareaction.org/page/-/ReducingRegulationReport.pdf [accessed 9 September 2016].

13. Do you have any other thoughts on the issues raised in this paper or on how standards of trusteeship and quality of governance?

The lack of training for trustees at small schemes compared with larger may explain why small schemes exhibit less knowledge and acceptance of evolving thinking on responsible investment. UKSIF's 2014 Ownership Day survey found that out of the 6% of pension funds who disagreed with the proposition that environmental, social and governance (ESG) factors are material to long-term performance of the fund, all were smaller funds (assets of under £5 billion).[34] Larger funds (assets over £10 billion) were also likely to be committed to the UK Stewardship Code whilst smaller funds (assets of under £2 billion) were most likely to say they had no intention of committing to the Code. The survey points out that there is "further anecdotal evidence that smaller funds find it more difficult to fully consider ESG issues due to lack of time, resources and in some cases understanding."[35]

We worked with Professional Pensions in August 2016 to produce an industry survey assessing the extent to which trustees, pension fund managers and advisors consider ESG factors, such as climate risk, to be financially material. This found that 53% of 101 respondents did not think climate change poses financially material risks to their portfolios or those of their clients. A further 16% of respondents did not know whether they thought climate risk was financially material to their portfolios or those of their clients. This is despite comments in 2015 from the Governor of the Bank of England, Mark Carney, that "[t]he exposure of UK investors… to these shifts is potentially huge… The challenges currently posed by climate change pale in significance compared with what might come… once climate change becomes a defining issue for financial stability, it may already be too late." Reports from sources such as The Economist Intelligence Unit and Citigroup have indicated that a scenario of 6°C warming could lead to a present value loss of US$13.8 trillion of manageable financial assets, roughly 10% of the global total (i.e. total stock of assets held by non-bank financial institutions)[36] and, at the same time, that if the investment system does not take steps to move towards a low-carbon economy, then it could be left with as much as US$100 trillion in "stranded" fossil fuel assets by 2050.[37]

Nearly one-third of respondents felt that the main barrier preventing climate risk being taken into account was a lack of perception on trustee boards that climate risk is a sufficiently high risk factor. 18% of respondents to the survey thought trustee education would help climate risk to be taken more seriously in pension investment decisions**.** As suggested earlier in this response, we recommend that the Pensions Regulator (and other relevant regulators) take steps to educate investment decision-makers on climate risk and other key ESG issues. In particular, this should cover why they should be considered as financially material risks and what steps can be taken to assess and manage the risk**.** This could include issuing guidance and adding additional sections to the Trustee toolkit on the Pensions Regulator's website.

We also feel it is essential to improve trustee education on the issue of member communications and engagement. ShareAction regularly creates "email tools" enabling savers to email their pension funds directly to request information on various issues. Through this process, we have gained insight into how funds share information. Member requests for information from their pension fund about where their money is invested and how ownership rights are exercised on their behalf often receive an inadequate response,

---

[34] UK Sustainable Investment and Finance Association, 'Attitudes to Ownership 2014', 2014. Available online at: http://www.plsa.co.uk/PolicyandResearch/DocumentLibrary/0379_attitudes_to_ownership_report_2014.aspx [acessed 9 September 2016].

[35] *Ibid.*

[36] The Economist Intelligence Unit. (2015). *The cost of inaction: Recognising the value at risk from climate change.* Available online at: https://www.eiuperspectives.economist.com/sites/default/files/The%20cost%20of%20inaction_0.pdf [accessed 9 September 2016].

[37] Citi GPS: Global Perspectives & Solutions. (August 2015). *Energy Darwinism II: Why a low carbon future doesn't have to cost the earth*. Available online at: http://climateobserver.org/wp-content/uploads/2015/09/Energy-Darwinism-Citi-GPS.pdf [accessed 9 September 2016].

and sometimes receive no response at all. When funds do respond, members are often pointed towards statements published by trustees or scheme managers which are usually very general, at times vague and "boilerplate". The new DC Code is a significant step forward in highlighting the need to communicate with members in a clear and accessible way, and explore different forms of engagement. It is important that the Pensions Regulator takes the next step and ensures that trustees are engaging with best practice recommendations through the kind of mandatory educational programmes we have discussed in this response.

We would be happy to meet to discuss any of the views raised.

Yours sincerely,

R Haworth

Rachel Haworth, Policy Officer