ASSOCIATION OF PENSION LAWYERS

Competition and Markets Authority
Victoria House
37 Southampton Row
25 The North Colonnade
London
WC1B 4AD

By email to: investmentconsultants@cma.gsi.gov.uk

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Dear Sirs

Investment Consultants Market Investigation – Working Paper: trustee engagement

I write on behalf of the Association of Pension Lawyers, a body representing members of the legal profession in the UK who specialise in pensions law, and pensions-related law. The Association of Pension Lawyers is a non-political, non-lobbying, not-for-profit organisation representing over one thousand members.

Our comments on the working paper are set out below. We have not directly answered the questions posed but have instead commented on the proposed remedies where our experience of providing legal advice to employers, trustees and members of trust-based and contract-based pension schemes could inform our comments. The experience of the Association of Pension Lawyers does not enable us to comment on every proposal and we do not comment on issues of policy.

1. Trustee guidance as a measure to improve governance standards

We agree that The Pensions Regulator would be best placed to issue guidance to encourage trustee engagement. We would, however, warn of the risk of saturation of regulatory guidance for trustees. Too much guidance can lead trustees to feel a degree of regulatory fatigue, reducing the impact of new guidance and/or making it difficult for trustees (particularly those of small schemes with less resources for advisers) to see 'the wood for the trees' and prioritise the key steps they should be taking.

As the paper rightly points out, there is generally no direct legal obligation to comply with guidance issued by The Pensions Regulator, however, in general, trustee boards of larger and medium sized pension schemes tend to feel that they 'should' or 'must' comply with the expectations of the Regulator. As such it is very likely like that guidance would have a direct impact on those schemes.

Trustees of smaller schemes are far more likely to have fewer resources and harder decisions to make regarding allocating those resources. As a general comment, we agree that smaller DC schemes can be less engaged because they have smaller budgets to deal with competing legal and practical demands that are similar to larger schemes. They are also sometimes (e.g. where they do not have access to regular professional advice) simply not aware of regulatory guidance or find it difficult to keep track of the vast body of guidance that has been published.

As such, if guidance is published, based on our experience, it should be well-publicised, easy to find and targeted. It should tell trustees what steps they should be taking and how to prioritise those steps, so

that trustees can comply in a proportionate manner taking into account the circumstances of their scheme and without any restriction on their duty to act in a way that best serves pension scheme members. The Pension Regulator's new commitment to clearly communicate how it expects trustees to act would play an important role.

Individuals react differently to different mediums and formats of information. We do, however, see the benefit in pro-forma documents and templates. They have the advantage of clarity, avoiding the traps of some current guidance that suggests the steps that trustees 'might' want to take without prioritising or clarifying the regulatory expectation. They also benefit smaller schemes by enabling trustees to do more themselves, perhaps incentivising them by reducing their reliance on costly professional advice.

2. Mandatory investment sub-committees

In our experience most trustee boards have either an formal or informal sub-committee that deals with the scheme's investment matters.

Whereas trustee boards of smaller schemes tend not to have an investment sub-committees, their boards can be small with all decisions being made by the full board. As such it is likely to be disproportionate, and of little practical benefit, to force these boards to set up an investment sub-committee and would do little to add to the robustness of trustee decision making and expertise.

In our experience, the use of an investment committee does not of itself increase the skills and understanding of the board. Having a smaller group of individuals has logistical benefits (e.g. organising meetings is easier) and can enable more focussed discussions to take place with those people with relevant experience. But the existence of a sub-committee does not necessarily result in a more engaged or educated trustee board as a whole. It is the trustee board that will determine the role and duties of the sub-committee. In addition, although sub-committees may have delegated authority to make some or all investment decisions, it is common for the sub-committee to make recommendations only in relation to strategic investment matters (which can include the appointment of advisers or managers and performance reviews) with the decision made by the full board based on the findings of the sub-committee.

3. New minimum requirements for lay trustees

We assume the distinction being made is between lay and professional trustees. As the CMA will know, the Pensions Regulator recently consulted on and finalised its description of what it would consider to be a professional trustee (http://www.thepensionsregulator.gov.uk/docs/professional-trustee-description-policy.pdf) and has done a lot of thinking about the role of professional and lay trustees as part of its 21st Century Trusteeship project (http://www.thepensionsregulator.gov.uk/21st-century-trusteeship.aspx). In addition, the Association of Professional Pension Trustees led an industry working group that published draft standards for professional trustees in December 2017 (http://appt.co.uk/?p=605).

Although it is generally accepted that higher standards are expected of professional trustees the legal requirements remain the same for all trustees. Current legal requirements for trustee knowledge and understanding (TKU) as set out in the Pensions Act 2004 and The Occupational Pension Schemes (Trustees' Knowledge and Understanding) Regulations 2006 do not distinguish between lay and professional trustees. This reflects the view, currently supported by The Pensions Regulator, that it is the skill and experience of the board as a whole that is key. For example, The Pensions Regulator's DC Code promotes diversity of board composition (http://www.thepensionsregulator.gov.uk/trustees/the-trustee-board.aspx). This approach has also been followed by The Pensions Regulator in its currently proposed approach to the assessment of the trustee board for the purpose of authorising DC master trusts. This recognises that, legally, it is the trustee board as a whole, not one or more individual trustees, that retains overall responsibility for the decisions made. The proposal risks creating a 'two tier' trusteeship, with different legal requirements, in the area of investment knowledge only. We have also observed that many schemes can find it difficult to recruit lay trustees, so increasing obligations on lay

trustees (only) may make this problem worse. In our experience, a lay trustee could have more investment expertise than a professional (e.g. if the lay trustee was the current or former chief investment officer of the sponsor). It does not necessarily follow that lay trustees need specific requirements.

4. Greater role of the sponsor to encourage market testing

The paper suggests strengthening the sponsor's role in suggesting the need to test the market, whilst noting that this should be consistent with the scheme's trust deed and rules.

In our experience it would be very rare for a trust deed and rules to give the sponsor any power or explicit role in decisions about how scheme assets are invested or asset managers selected. The sponsor might have a very limited role in the appointment of advisers (e.g. consultants) if, for example, the trust deed and rules require the sponsor's agreement to the remuneration and general appointment terms of the adviser. The sponsor will of course have to be consulted on the scheme's statement of investment principles as required by the Pensions Act 2005 and The Occupational Pension Schemes (Investments) Regulations 2005. Of course in practice, the sponsor may also be directly funding consultancy or investment management fees (both in DB and DC schemes, depending on the scheme rules and the sponsor's approach), and so is likely to have a degree of commercial influence over the trustees.

However, the ultimate decision as to when to appoint, review or change an investment consultant or manager sits with the trustees in line with their legal duties – i.e. to promote the purpose of the trust and act in member interests.

Introducing a requirement on the sponsor to suggest or require that the trustees test the market could place the sponsor in a difficult position, as it is likely to be able to do little more than simply ask the trustees to do this. It would have no ability to force the trustees to do so. It could use commercial pressures (e.g. referring to funding or the payment of expenses) but that may not always be in the interests of scheme members if the trustees had decided a market review was not a priority for scheme resources at that time and undue pressure may damage the sponsor's relationship with the trustees. Giving the sponsor a legal power to force the trustees to change consultants or managers or test the market would change the 'balance of power' between sponsors and trustees.

5. Strengthening value for money requirements

The legislation regarding 'value for money' assessments for DC schemes is contained in Regulation 23 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996, which requires the Chair's statement to comment on the extent to which charges and transaction costs represent good value. The term 'value for money' (known as 'value for members') was a concept introduced and developed by The Pensions Regulator in its DC Code and guidance. Current understanding is that 'good value' for the purpose Regulation 23 is akin to 'value for money' (and The Pensions Regulator's recent guide to the Chair's Statement refers back to its guidance on 'value for money': http://www.thepensionsregulator.gov.uk/docs/chair-statement-quick-guide.pdf).

However, in our experience, there remains a lack of clarity over the scope of the legal obligation and a lack of uniformity amongst trustee boards and advisers as to how a value for money assessment should be carried out. In the main this is because relevant information was, and to some extent is still, not available and/or disproportionate to access - e.g. member values and views as to what they consider to be valuable, and sufficient charges and transaction costs. In turn, the industry (in practice led by the work of Independent Governance Committees) has been left to develop a consensus of approach. And we are also seeing new legislation and FCA rules to encourage greater transparency and disclose of charges and costs from asset managers, which aims to enhance the information available for a value for money assessment.

If any additional requirements for value for money assessments are introduced it would be helpful if they were specific and realistic. For example, if explicit benchmarking of fees and performance is mandated,

it would be helpful if trustees are able to obtain this information in a standardised form, to avoid disproportionate resources being allocated to this item of governance and to enhance the reliability of the assessment.

It is unclear whether new requirements would be introduced in guidance or legislation. The current legislative requirement is quite high level which has the benefit of flexibility for trustees (if they simply cannot access the relevant data) and regulators (so they can adapt the approach as the market develops). For this reason the Pensions Regulator may want to address any new requirement in guidance.

There may be practical difficulties in introducing a value for money assessment for DB (and hybrid) schemes. Compared with DC schemes, DB schemes can enter into more complicated investment vehicles with more complex fee structures, which make it harder to discern the precise fees and accurately benchmark them. We had understood that the policy rationale for introducing a value for money assessment for DC schemes was to assess the value of the services that members effectively 'pay' for (via charges), and publicise that information to enable members to decide whether they are in the right savings vehicle. We cannot comment directly on policy. However, the legal structure of a DB scheme is such that no one member directly funds investment charges or costs. Ultimately the aggregate cost is borne by the asset pool and, in the event of deficit, the sponsor which is why DB scheme trustees have greater flexibility to utilise more complex investment vehicles. A value for money obligation may not interact well with the trustees' duties to investment in the long-term interests of members in DB schemes. If any duty was introduced in respect of DB or hybrid schemes the new measures should be co-ordinated with DWP's intention to introduce a DB Chair's Statement as stated in the recent White Paper on Protecting Defined Benefit Pension Schemes: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/693655/protecting-defined-benefit-pension-schemes.pdf

6. Mandatory tendering or switching

We agree that mandatory tendering would increase costs for trustees, the amount of which would depend on the scope of the tender process and the amount of professional advice that is taken.

Mandatory switching, in our view, would cut across the trustees' legal duty to further the purpose of the pension scheme and act in members' interests. Legally speaking we would view it as the role of the trustees to decide when and why a switch should take place. To introduce mandatory switching would mark a significant change to the legal role of the trustees in this respect.

Finally, the paper talks about how advisers (other than investment consultants) can help trustees monitor and scrutinise investment consultants and fiduciary managers. The role of legal advisers is generally limited to reviewing contractual documentation (e.g. appointment documents, or investment management agreements) and advising on the trustees' legal duties in terms of the investment of scheme assets. As a general comment, legal advisers will not generally be qualified to provide an educated opinion regarding the qualifications, experience of performance of investment consultants or fiduciary managers. We agree that the scheme actuary, the sponsor (and their actuarial or financial advisers) and other investment consultants would be best placed to comment on the role and performance of the investment advisers or managers.

If you would like to discuss, please do not hesitate to contact Anna Copestake (anna.copestake@arcpensionslaw.com) or Hugh Gittins (hughgittins@eversheds-sutherland.com).

Yours sincerely

Anna Copestake
For and on behalf of the Association of Pension Lawyers