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(Sent via online form)

24th September 2019

Dear Mr Potter,

Consultation on future of trusteeship and governance

I am writing to respond to The Pension Regulator's consultation on trusteeship and governance on behalf of ShareAction, a registered charity established to promote transparency and responsible investment 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 26,000 individual supporters. We have responded to questions 1 to 9 below, as we felt these were the areas most relevant to our expertise.

Q1: Do you agree that the expectations set out in the 21st century trusteeship campaign is a good starting point for defining a minimum standard for trustee knowledge in the code? Is there anything else that should be added that would be necessary for all trustees to know?

ShareAction welcomes TPR's proposals to improve the standard of trusteeship and governance in pension schemes. Our broad vision of how the investment system should be reformed encompasses four aspects: ensuring financial institutions account for their impact on people and planet; ensuring investors and investee companies act within safe ecological limits; that these actors build a fair, just and healthy society; and that the investment system is diverse and inclusive at all levels. Pension scheme trustee boards have a role to play in respect to all four of these goals; effective trusteeship and governance of pension schemes goes hand-in-hand with pursuing them.

We agree that the expectations set out in this campaign are a good starting point for defining a minimum standard for trustee knowledge in the code. We were pleased to see that climate risk was included as an example of a risk that trustees should be considering. Trustee awareness and consideration of climate risk (as well as other ESG risks) is still too low. For example, ShareAction's 2019 ranking of the climate risk management practices of the pension schemes for 25 FTSE 100 companies found that only two (of the 15 schemes that responded) currently have default funds that have been explicitly constructed to reduce exposure to climate-related risks.[1]

Our 2018 ranking of the 10 largest UK auto-enrolment pension providers on responsible investments found that NEST was the only provider that incorporated climate-related financial risks when setting the default funds' investment managers' performance objectives and requirements for reporting, and the only provider to have a measurable and time-bound target to reduce the

[1] ShareAction (February 2019). *Will Employees Benefit?*, p. 25. Available online at: https://shareaction.org/wp-content/uploads/2019/02/CorporatePensions2019.pdf [accessed 24 September 2019].

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portfolio's exposure to climate-related financial risks.[2] While NEST scored 86%, no other auto-enrolment pension provider scored above 32%[3], a finding which would provide strong evidence that climate-related financial risks are not addressed sufficiently by auto-enrolment default funds.

We would suggest that the example risk register linked to in the guidance includes an investment risk section that includes climate risk.

Q2: Should there be legislative change for trustees to demonstrate how they have acquired a minimum level of TKU, for example through training or qualification?

We agree trustees should be required to demonstrate that they have acquired a minimum level of TKU. We were concerned to note in TPR's recent landscape DC research that, despite its expectation that trustees should establish and maintain a clear policy for assessing the fitness and propriety of individuals appointed to the trustee board, only 58% of all trustees confirmed that they do so.[4]

However, requiring lay trustees to achieve set qualifications would muddy the distinction between them and professional trustees. It may also exacerbate the existing challenges around recruiting lay trustees, since a requirement to achieve qualifications could put people off applying for the role. We think it makes more sense to require trustees to undertake regular training and carry out short tests to ensure they are processing and able to apply the relevant information.

Q3: Should there be a legislative change to introduce a minimum level of ongoing learning for all trustee, for example through CPD-type training? If so, how many hours a year would be suitable?

There have been legal clarifications in recent years on the nature of fiduciary duty, and this should be reflected in TKU. Trustee training should reflect the fact that their responsibilities have evolved to incorporate the impacts of investment on society and the environment.

We believe trustees should be required to complete regular online training exercises, followed by a timed test with a specific pass mark. These training exercises could be used to refresh trustees' understanding of their key duties, as well as update them on changes to the law, investment landscape etc. This approach is frequently used to ensure professionals are aware of their responsibilities, such as those relating to money laundering rules. The existing Trustee Toolkit could be used as a starting point.

The number of hours per year should be set based on what The Pensions Regulator anticipates will be necessary to ensure all trustees have good levels of TKU, rather than how many hours trustees signal they wish to spend on training.

Interviewees in our 2015 research, *Realigning Interests, Reducing Regulation* (*RIRR*)[5] emphasised that lay trustees need to be given time off by employers for training as well as to attend board meetings. Employers could be reimbursed from the scheme for the paid hours that an MNT spends on pension scheme duties. There is a precedent for individuals balancing full-time or part-time jobs with public duties: magistrates, local councillors, school governors, health authority beneficiaries, trade unionists and beneficiaries of Army Reserve forces all have rights to time off work to fulfil these duties under the Employment Rights Act 1996. This Act should be amended so that member-nominated trustees have the same rights to request reasonable time off work to fulfil their

[2] ShareAction (June 2018). *The Engagement Deficit*, p. 43. Available online at: https://shareaction.org/wp-content/uploads/2018/06/TheEngagementDeficit.pdf [accessed 24 September 2019].
[3] Ibid.
[4] TPR (September 2018). *DB research response,* p. 8. Available online at: https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-research-response-2018.ashx [accessed 24 September 2019].
[5] ShareAction (June 2015). *Realigning Interests, Reducing Regulation*. Available online at: https://shareaction.org/wp-content/uploads/2016/01/ReducingRegulationReport.pdf [accessed 24 September 2019].

duties as magistrates, school governors, trade unionists, beneficiaries of the Army Reserve forces and other roles prescribed in the legislation.

Q4: Do you agree that we should set higher expectations on levels of TKU held by professional trustees in the code, recognising that they typically act across multiple schemes of various types, size and complexity?

Yes, it seems only logical that professional trustees should be held to higher standards on TKU since they typically have responsibilities to a wide range of schemes to which they are not personally connected.

Professional trustees are usually perceived as bringing higher standards of knowledge to the trustee board, and this needs to be reflected in practice. From interviews conducted by ShareAction for our 2015 *RIRR* report it was reported that professional trustees did not always effectively challenge consultants on fees and charges, and did not pay due attention to the importance of member communication.

Q5: Should we focus more on establishing and setting standards and ensuring all trustees are aware of them, while relying more on industry to have the main role in educating trustees in ways more tailored to their individual needs?

In our view, it is important for TPR to work with industry more directly to ensure trustees are reaching consistent outcomes in their knowledge and understanding. This is because setting standards may not be sufficient for disengaged trustees. As David Fairs, executive director for regulatory policy, analysis and advice at TPR, said recently: “The most disengaged trustees are blissfully unaware that they are failing savers by not running their schemes properly.”[6]

In some cases, training provided by industry advisors may be influenced by their commercial concerns as much as their dedication to filling in trustee gaps in understanding. For example, some interviewees in our *RIRR* research paper suggested that training should include negotiation skills to make sure trustees have the confidence to challenge providers. 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.”[7]

We suggest that TPR could work collaboratively with industry to produce standardised online training and testing on key areas of knowledge to ensure minimum standards are met, while encouraging industry to continue carrying out more in-depth face-to-face training.

Q6: We would also welcome any thoughts or ideas that you might have more generally about how we can have greater confidence that trustees have the necessary basic knowledge and understanding to carry out their role.

Mandatory trustee training should include detailed training on how to integrate environmental, social and governance (ESG) factors, including climate risk, in their investment approach, including how to ensure it is a clear part of asset managers’ mandates. They will need to have adequate knowledge of this area to fulfil the new legislative requirements to update their Statement of Investment Principles and report on steps taken to implement it.

Research from Sackers, Professional Pensions and Hermes quoted in the DWP’s consultation on this area indicated that a worryingly large proportion of trustees still do not see issues around the

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[6] TPR (1 August 2019). *New figures show why small schemes must quit market.* Available online at: https://www.thepensionsregulator.gov.uk/en/media-hub/press-releases/new-figures-show-why-small-schemes-must-quit-the-market [accessed 24 September 2019].

[7] ShareAction (June 2015). *Realigning Interests, Reducing Regulation*, p. 28. Available online at: https://shareaction.org/wp-content/uploads/2016/01/ReducingRegulationReport.pdf [accessed 24 September 2019].

long-term sustainability of a company as likely to affect investment returns, and therefore member outcomes.[8] As stated above, ShareAction's 2019 ranking of the climate risk management practices of the pension schemes for 25 FTSE 100 companies found that only two (of the 15 schemes that responded) currently have default funds that have been explicitly constructed to reduce exposure to climate-related risks.

Q7: Should there be a requirement for UK pension schemes to report to the regulator on what actions they are taking to ensure diversity on their boards? Should such a requirement be limited to schemes above a certain size? How should such a report be made to us?

As outlined in the consultation document, greater diversity of viewpoints helps pursue better outcomes for savers. We believe the investment system should be diverse and inclusive at all levels, including that of trustee boards.

We think schemes should be required to report to the regulator on what they are doing to ensure diversity on trustee boards. It is in the interests of the scheme membership as a whole when their make-up is reflected at board level. There are inequities in the level of saving across scheme membership that improved diversity on boards could help redress. If governance groups better reflect the diversity of the wider group they represent, their collective life experiences will improve their capacity to understand the unique challenges faced by different social groups within their scheme membership.

Calculations of the income 'replacement rate' a worker will achieve in retirement (compared with their pre-retirement income) if they contribute certain percentages of their salary to their pension fund are still predicated on the assumption of 40 years of full-time work. This may be typical for a male worker but is rare for females as a result of working part-time or taking career breaks to fulfil caring responsibilities.[9] Many women thus do not build up enough savings when in fact they need more due to increased female life expectancies; two-thirds of pensioners in poverty in the UK are female.[10] The finance sector remains male-dominated across the board; for example a study of small trusts in the UK found 84% of trustees are male.[11] The disconnect between trustee board priorities and the wider membership base is not surprising.

Identity diversity in the governance structure is important for other groups apart from women; one interviewee for ShareAction's 2015 *RIRR* study pointed out that member-nominated trustees in schemes they had worked with had been instrumental in pushing for same-sex couples to have rights in relation to their partners' pension pot, for example. There will be a host of financial challenges particular to people of a certain gender, sexual orientation, or ethnicity, which diversity reporting can help address.

The diversity reporting requirement should apply to schemes of all sizes that have more than one trustee on the board. The impact on decision-making will be the same, regardless of the size of the scheme's membership. In the interest of generating good returns for members, all schemes should be driving towards trustee diversity.

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[8] DWP (June 2018). *Consultation on clarifying and strengthening trustees' investment duties*, pp. 8-9. Available online at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/716949/consultation-clarifying-and-strengthening-trustees-investment-duties.pdf [accessed 24 September 2019].

[9] ShareAction (June 2015). *Realigning Interests, Reducing Regulation*, p. 23. Available online at: https://shareaction.org/wp-content/uploads/2016/01/ReducingRegulationReport.pdf [accessed 24 September 2019].

[10] Fawcett Society, (March 2012). *The Impact of Austerity on Women*, p. 12. Available online at: https://www.fawcettsociety.org.uk/Handlers/Download.ashx?IDMF=f61c3b7e-b0d9-4968-baf6-e3fa0ef7d17f [accessed 24 September 2019].

[11] Smith, I. (14 November 2014). "Pensions Trust reflects on trustee election after diversity move," *Pensions Expert*. Available online at: https://www.pensions-expert.com/DB-Derisking/Pensions-Trust-reflects-on-trustee-election-after-diversity-move?ct=true [accessed 24 September 2019].

Q8: Should industry play a role in creating tools, guidance and case studies that can help pension schemes attract a more diverse pipeline of lay trustees? How would that work and who should take a lead in making it happen?

To create a more diverse pipeline of lay trustees, there is an underlying need to engage with scheme membership more broadly. If the membership is engaged, a larger and more diverse pool of potential trustees is created. A 2017 DWP review of automatic-enrolment made a point of 'strengthening the engagement of individuals with workplace pensions so that they have a stronger sense of long-term personal ownership and are better able to understand and maximise savings.'[12] Since that review was conducted, member engagement – or lack of it – remains an issue.

Many savers have reported being dissatisfied with communications from their pension scheme: studies have shown that 19% of workers are happy with current communication strategies on their employee benefits,[13] active registrations for pension providers' online platforms are typically under 10%,[14] and 49% of savers report that their annual statement was the only communication they received from their pension scheme.[15]

On the part of industry, greater innovation is needed to engage members. Pension schemes should explore initiatives like surveys, roadshows and other forums in which to engage savers. Utilising focus groups of savers could also serve this purpose. On the part of the regulator, we believe the big automatic-enrolment pension providers should be required to report to TPR on levels of registration with their online platforms.

The lack of responsible investment by pension schemes could also be redressed here. Many pension scheme members have expressed desire for their savings to be invested responsibly. In a 2016 LGIM survey, 84% of savers stated they would prefer a pension that uses investments to encourage companies to be more responsible.[16] The millennial demographic has shown particular interest in this regard – a 2016 PwC survey reported 68% of 25-34 year olds stated it is important that people use their money for the good of society and the wider world.[17] Conversely, from ShareAction's 2018 survey of automatic-enrolment providers, a preliminary evaluation of the results found there is very little diversity across age groups on trustee boards, with young people particularly affected. To rectify this, one part of the solution should be to engage with savers on matters important to them, such as responsible investment. A more engaged foundation of savers will result, creating a more diverse pipeline of trustees.

Simply referring to 'responsible investment' will not automatically engage savers; to enthuse savers – and potential trustees – pension schemes should be conscious of savers and their individual priorities. At a 2018 roundtable hosted by the Defined Contribution Investment Forum, Rhys Williams of the consultancy Quietroom highlighted the importance of framing discussions in terms of what savers will understand and relate to. He commented that use of arcane financial language about integration of ESG into the investment process was a non-starter; instead, savers should be asked what issues they care about, and build the dialogue around this.[18]

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[12] DWP (February 2017). *Review of Automatic Enrolment – Advisory Group Terms of Reference*, p. 2. Available online at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/590221/terms-of-reference-automatic-enrolment-review.pdf [accessed 24 September 2019].

[13] Thomsons (2016). *UK Employee Benefits Watch 2016/*17, p. 38. Available online at: https://www.thomsons.com/media/1876/uk-employee-benefits-watch-201617-report.pdf [accessed 24 September 2019].

[14] ShareAction (March 2018). *Pensions for the Next Generation*, p. 18. Available online at: https://shareaction.org/wp-content/uploads/2018/03/NextGenerationPensions.pdf [accessed 24 September 2019].

[15] YouGov (2015). YouGov/PRI responsible investment survey 2015.

[16] LGIM (7 November 2016). *LGIM launches multi-factor fund that also addresses climate risk*. Available online at: https://www.legalandgeneralgroup.com/media-centre/press-releases/lgim-launches-multi-factor-fund-that-also-addresses-climate-change-risk-hsbc-bank-uk-pension-scheme-first-to-adopt/ [accessed 24 September 2019].

[17] PwC (December 2016). *Social Investment Demand: research findings December 2016.*

[18] Defined Contribution Investment Forum (January 2019). *Making responsible investment tangible*, p. 7. Available online at: https://www.dcif.co.uk/wp-content/uploads/2019/01/making-responsible-investment-tangible-final.pdf [accessed 24 September 2019].

Q9: Should it be mandatory, in due course, for each pension scheme board to engage a professional trustee? If not what reasons (other than current capacity) would make such a move undesirable?

We would emphasise that the presence of professional trustees, while doubtless providing valuable expertise to trustee boards, are not a silver bullet for effective management of pension schemes. There is much to be done to raise standards in the pensions sector, particularly with regard to areas such as member engagement and responsible investment. Were engagement of professional trustees to become mandatory, it should be done in a way that ensures their service on the board adequately addresses these areas. We are concerned also that presence of professional trustees may give rise to complacency in pension schemes, feeling that the scheme is in 'safe hands' when areas such as member engagement/responsible investment receive insufficient attention. We want to see effective, engaged team working between professional and non-professional trustees, which works to a common high standard. Overall the focus should be less of the balance of professional/non-professional trustees on boards, and more on the quality of trusteeship exercised by the board as a whole.

There is evidence of professional trustees neglecting some standard duties, which lay trustees are not so wont to do. As previously referred to from ShareAction's 2015 *RIRR* report, it was reported that professional trustees were lacking in some areas, including the need to challenge consultants on fees and charges, and paying due attention to member communication.

As we have established, many pension schemes have failed to effectively mitigate ESG risk to portfolios. Trustee boards are failing to take sufficient action – for example, only two of the 10 employer-sponsored trusts surveyed have added climate change to their scheme's risk register.[19] We cannot isolate the lack of ESG risk-mitigation to one type of trustee, whether that be professional or otherwise. However, it is clear that across the sector, many trustee boards of varying make-ups are failing to mitigate ESG risk. TPR has codified standards expected in this regard, so that the performance we expect from professional and non-professional trustees alike is raised. The recent updates made to the Trustee Toolkit, and to investment governance guidance, have made clear that ESG risk mitigation is required by trustees. However we need to go further to ensure trustees are engaged and paying sufficient attention to this advice. Assessments of TKU should include ensuring these updates to the Trustee Toolkit and investment governance guidance are fully understood and reflected in the board's trusteeship.

This is not to argue that the value of lay trustees outweighs professional ones, or vice versa. Rather it is important to bear in mind that the trustee board as a whole should be evenly bear out the responsibilities of their role.

Yours sincerely,

David O'Sullivan
UK Policy Officer, ShareAction

[19] ShareAction (February 2019). *Will Employees Benefit?*, p. 26. Available online at: https://shareaction.org/wp-content/uploads/2019/02/CorporatePensions2019.pdf [accessed 24 September 2019].