Association of Professional Pension Trustees

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Dear Sirs

Joint DWP and HMT call for evidence on Pension trustee skills, capability and culture

I am writing on behalf of the **Association of Professional Pension Trustees (APPT)** in response to the above call for evidence.

The APPT acts as the representative body for trustees of occupational pension schemes who fall within the Pension Regulator's description of professional trustee as set out in its August 2017 policy document. The APPT maintains a set of standards for professional trustees to improve and provide assurance on the quality of professional pension trustees. The APPT also oversees the process by which members may become Accredited (since 2020) and presently accredits close to 400 Professional Pension trustees.

The APPT acts as the collective voice of the profession and we estimate that our members work as trustees on over 2,000 schemes of all types, being widely represented on defined benefit (DB) schemes and including many trustee boards for defined contribution (DC) schemes including DC Master Trusts. Our members each typically work on multiple appointments and in total are responsible for managing schemes with assets of over £1,200 bn.

Executive summary of our response to the evidence call:

Knowledge and understanding

- Amongst accredited Professional trustees we believe that trustee requirements are well understood, and Professional trustees recognise that they are held to a higher standard of care. Whilst we are aware of unaccredited Professional trustees who work to high standards, we are not able to confirm one way or the other how many of them fall into this bracket.
- Knowledge and understanding of lay trustees could be monitored more closely by the Pensions Regulator, for example with an addition to the annual scheme return requiring confirmation by the Chair of trustees that all trustees have met their TKU requirements.

- We support the planned major overhaul by TPR of the Trustee Toolkit, or whatever replaces it, as the recognised source of minimum required trustee knowledge and understanding.
- For Professional trustees who follow the accreditation regimes there are already checks on knowledge, understanding and standards made ahead of accreditation being achieved and annual checks made including submission of the previous year's Continuous Professional Development record.
- The APPT has recently **reviewed its accreditation process** to make sure it continues to be in line with the standards currently required.

Trustee Register

- Before further administrative requirements are added for lay trustees beyond those already required in the TPR Scheme Return document there needs to be careful consideration as to the purpose of such a register of trustees, what use it is intended to be put and how this will improve the protection of members' benefits. There is already a register of Accredited Professional Trustees. If a Register is set up it should be drawn from information collected in the TPR Annual Scheme Return.

Accreditation

- Our understanding is that very few lay trustees have chosen to accredit under the voluntary accreditation framework set up in 2021. The broad range of skills, qualifications, and experience of lay trustees, together in many cases with their first-hand knowledge of the businesses that sponsor pension schemes, is a vast resource that has underpinned the good governance of most UK trust-based schemes over the last century and beyond and should not be under-estimated.
- Careful consideration is needed before placing accreditation requirements upon lay trustees. A likely outcome would be that the recruitment of lay trustees becomes even more difficult than it can be at present for many schemes.
- The APPT accreditation frameworks for Professional trustees set up in 2020 has proved a great success and is 'fit for purpose' with close to 400 APPT Professional trustees voluntarily accrediting. Those who have accredited meet knowledge and understanding, educational, continuous professional development and 'fit and proper' requirements and are reviewed annually.
- We include herein recommendations for further enhancements to the framework following the *2023 APPT Accreditation Review.*
- We strongly recommend that the accreditation of Professional trustees is made mandatory to ensure consistent high levels of scheme governance. This will enable the frameworks to be further enhanced over time.

Better scheme governance

- We favour a gradual move whereby schemes meeting certain criteria, for example schemes of a certain size or category are required to appoint a Professional trustee. We recommend that in consultation with TPR and industry, a decision is made on the most practical approach given the resources available, so government can set a phased introduction over a few years for the requirement for schemes to appoint at least one Professional trustee.

- That phasing should be flexible enough to take account of any significant consolidation of schemes over the next few years and might take account of different sizes and categories of schemes, together with any other relevant criteria, to be the priority candidates.

The role of advice and support for unlisted equities

- Investment consultants support trustees in their investment decision making by putting forward strategies which meet the goals of the scheme. Such advice is required under law.
- For trustees to decide to invest in unlisted equities it is important that there are investable products which meet the varied needs of schemes.
- It is likely that there would need to be further amendments made to the DB Funding Regulations allowing TPR to adapt its DB funding guidance to enable trustees to be confident in accepting the additional/different risks involved.
- For DC schemes, subject to the availability of suitable funds and structures, an option to invest in unlisted equities may be in members' long-term interests but would need to be balanced against the additional risks involved, such as increased cost and illiquidity. These risks may exclude smaller DC schemes.
- Given that Trustees are legal asset owners, investing on behalf of the scheme beneficiaries, their fiduciary duties under trust law and legislation and regulation tend to result in investing in asset classes which are commonly perceived to involve lower risk and therefore lower return.

Our responses to your specific questions are set out in the appendix to this letter.

We hope that you find the contents of this letter of assistance. We would be happy to discuss them further if that is helpful. In that event, please contact me at the email below or on 07526 167132.

Yours faithfully

Harus Rai,
Chair
On behalf of the Association of Professional Pension Trustees Limited
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APPENDIX

Response from the Association of Professional Pension Trustees Evidence call: Trustee skills, capability and culture

1. Do trustees know what the knowledge and understanding standards expected of them are?

2. Do trustees currently meet the knowledge and understanding requirements expected of them? Are some types of trustees better than others?

Introduction:

It is important that trustees are not seen as one amorphous category. In many of the questions below we distinguish between **lay trustees** appointed either by Sponsors or scheme members (MNTs), where very few trustees are accredited and can thereby evidence that they have achieved certain standards of knowledge and understanding.

Across non-accredited lay trustees, we believe there is ample evidence from research by the Pensions Regulator (TPR) and others that there is not a consistent amount of knowledge and understanding across all lay trustees. Indeed, it would be unusual if there was consistency given the differences in scheme sizes and resources and the difficulties, in many cases, for lay trustees in embracing the steady flow of additional requirements falling upon trustee boards.

One of our members summarised her experience:

> *"Over the time I have been a professional trustee the expectations of and pressure on trustees has increased significantly. The workload has increased enormously and has probably at least doubled over that time. Further, trustees are now being put in the front line of attempting to hold back the tide of climate change (through TCFD requirements) as well as being saddled with enormous amounts of bureaucracy on scheme governance. In addition, recent regulatory pronouncements seemed to suggest that trustees should be mindful of the wider systemic economic consequences of their actions (e.g. through investing in LDI) as opposed to fulfilling their fiduciary duties to members. Trustees are also being faced with efforts to increase diversity and inclusion whilst at the same time potentially meeting higher standards and more time commitment – as is hinted in this consultation. There needs to be a realistic limit to what can be placed at the door of trustees, professional or otherwise!"*

Separately, in many of the questions below, we refer to **Professional trustees** where close to 500 are now fully accredited (more details in the answer to Q8 on what this entails).

However, there remains a tranche of unaccredited Professional trustees, where standards of knowledge and understanding are uncertain, due to the present absence of any mandatory requirement for the unaccredited Professional trustee to evidence achieving certain minimum standards or for them to observe the **Standards for Professional Trustees of Occupational Pensions**, which were launched in March 2019, with the approval of the Pensions Regulator, and which accredited Professional Trustees must observe.

Lay trustees: In our view lay trustees fall in to three broad categories:

- Some lay trustees, including many lay chairs of trustee boards, do understand what is expected of them and fulfil their duties to the best of their ability. Such trustees often add material value to the running of the scheme,
- Some lay trustees do understand what is expected of them but do not have the time to fulfil their duties fully because they are too busy with their day job or are not provided with sufficient time or resource to fulfil their potential,
- Some lay trustees appear to be unaware or do not understand what is expected of them. We understand there are still many who do not and have not even, as a minimum, completed the Pensions Regulator's trustee toolkit.

TPR survey data in the call for evidence paper suggests that most lay trustees are likely to fall into the third category and that it is usually lay trustees working on the largest schemes that fall into the first bullet point.

Professional trustees:

Amongst accredited Professional trustees we believe that trustee requirements are well understood, and Professional trustees recognise that they are held to a higher standard of care. Whilst we are aware of unaccredited Professional trustees who work to high standards, we are not able to confirm one way or the other how many of them fall into this bracket.

The Professional Standards for accredited trustees require a minimum of 25 hours of Continuous Professional Development (CPD) to ensure that an individual's knowledge and understanding is extended and maintained, and this must be evidenced annually. Many accredited professional trustees far exceed the 25-hour minimum.

Accredited Professional pension trustees because of their training and experience have a greater understanding of what is required of them. Most of them are specialist pensions experts with deep knowledge of regulatory requirements or have other relevant backgrounds. They also have a strong understanding of the technical aspects of running a pension scheme (e.g. the impact on the scheme of investing in different assets classes) as well as wider skills such as managing advisers and negotiating with an employer.

3. What are the barriers to improving trustee capability? What do you think government should do to ensure that all trustees meet the standards expected of them? Does trustee liability put off potential trustees?

All trustees: It is already a requirement under the Pensions Act 2004 for all types of trustees to obtain and maintain knowledge and understanding.

- **This could be monitored more closely by the Pensions Regulator, for example with an addition to the annual scheme return requiring confirmation by the Chair of trustees that all trustees have met their TKU requirements.**
- **A Trustee Board level evaluation of the skills required for the role should also occur on an annual basis with confirmation in the return that this has been done and that all trustees have either met the requirements or that steps are in place to ensure they meet the requirements.**

- **We support the planned major overhaul by TPR of the Trustee Toolkit, or whatever replaces it, as the recognised source of minimum required trustee knowledge and understanding**.
- Most trustee boards already require new trustees to complete the TPR Trustee Toolkit. Subject to the point above we consider this provides good baseline knowledge. Monitoring this is challenging. TPR maintains a register of all individuals acting as trustee in their own right or representing a professional trustee firm and having that register linked to the register of individuals completing the TPR Trustee Toolkit would assist in overseeing any requirement to make completion of the toolkit mandatory across all pension trustees.

Lay trustees:

- For the majority of lay trustees, the role is entirely voluntary and with increased governance requirements many are not able to commit the time to carrying out the role to their full potential.
- It has been suggested by some that the wider accreditation of lay trustees might help generally to raise standards. We say more about this in our answer to Q8, but depending on the rigour of the process we would observe that a mandatory requirement placed on lay trustees could prompt many lay trustees to stand down (recruitment at many schemes already being a major headache). Adding to the regulatory load could result in loss of capable individuals who presently offer a valuable resource to many schemes in making challenging decisions and discussing and debating the recommendations of advisers.
- Most trustees have advisers to help them meet the requirements, and we would suggest that DWP/TPR should be careful not to distract trustees from scheme business with mandatory requirements for additional training which may not be relevant in all circumstances.

Professional trustees:

For Professional trustees who follow the accreditation regimes there are already checks on knowledge, understanding and standards made ahead of accreditation being achieved and annual checks made including submission of the previous year's Continuous Professional Development record.

The APPT has recently reviewed its accreditation process to make sure it continues to be in line with the standards currently required. We include in our answers to Q8 below a review of the findings and recommendations made for further enhancements to the accreditation requirements. For more details, including the background to accreditation, see **APPT 2023 Accreditation Review** (a copy of this paper is also enclosed with this evidence response).

4. Do trustees (including Master Trust trustees) have the right knowledge and understanding to invest in the full breadth of investment opportunities? If not, what can be done to improve this?

TPR Trustee Toolkit information on the full breadth of investment opportunities is limited and high level and does not necessarily reflect the latest position. The risks associated with each asset class are barely touched on in the toolkit.

In addition, investment strategy decisions are made with reference to the strength of the covenant provided by the scheme sponsor. The toolkit does not currently include a module on covenant assessment.

A revision of the Trustee Toolkit to review and potentially add to the modules on investments and funding, and to include a module on covenant assessment, would be extremely helpful in improving knowledge and understanding, notably for lay trustees.

While some trustees have specialist investment knowledge or prior investment experience, all trustees are required to obtain investment advice from someone who is suitably qualified, although experience shows that as pension solutions become more complex it can be difficult for trustees to understand all the nuances.

Where there are knowledge gaps trustees are reliant on their investment consultants or other advisers to provide them with sufficient training to enable the trustees to challenge both the consultant's recommendations as well as presentations from investment managers.

However, the advisers themselves may not have a full understanding of the full breadth of assets classes available and/or may have their own vested interests. This in turn may influence the approaches that trustees take to investment strategy and the asset classes used.

The use of specialist trustees could be adopted. For example, trustees with investment experience/qualifications to help the wider Boards or sole trustee teams to invest more positively. This will tend to be appropriate for larger schemes (including Master Trusts), but not be appropriate for smaller schemes (say below £100m assets) that cannot necessarily invest in bespoke assets nor commit as much time or resource to governance.

Caution should be exercised in assuming that because a particular asset class (for example UK private equity) is not widely invested in by pension schemes it is because the trustees are incapable of understanding it. Instead, other reasons for not investing in such assets may be, for example, that the asset would not have a suitable role to play in an appropriate investment strategy for the scheme or that no investable product exists or access to such a product is not possible.

5. Is there enough understanding of advice around the consolidation of schemes?

In the DC world the potential benefits of consolidation are increasingly understood. This has been driven to a large extent by regulatory pressure. The process is well advanced as evidenced by the TPR *DC trust: scheme return data 2022 to 2023*, with the number of occupational trust-based DC schemes with 12 or more members but fewer than 5.000 members reducing over the last decade from 2,580 to 1,090, with only around half a million members left in such schemes. In asset terms, the 130 DC schemes with 5,000 or more members now hold £135bn (around 94% of all occupational DC assets). The consolidation of DC schemes was given greater impetus by the requirements set for approved AE schemes and we expect the trend set over the last decade to continue. We are also seeing consolidation in the number of DC Master Trusts with a smaller set of much larger Master Trusts being created which, it is argued, should drive better member outcomes.

In the DB space consolidation is very much in its infancy. Whilst the Pensions Regulator previously released its approach to consolidation, we only now (in 2023) have the DWP response to the 2018 consolidation consultation. We also still await draft consolidation regulations. Without these it is difficult for most trustees and Sponsors to understand the legal/regulatory steps needed to engage with consolidation vehicles, although the recent easing of the guidelines to gateway principles may help to prompt some activity.

However, it needs to be noted that the costs involved in moving a DB scheme to a consolidator can be considerable (relative to the size of the scheme). This precludes the consolidation option for many schemes.

We note that there has been a proposal from the Tony Blair Institute for a wider and more radical consolidation of both DC schemes and DB schemes with early action to consolidate around 4,000 DB schemes into the PPF or a few PPF-like superfunds. We have commented more on this in our response to the 'Options for Defined Benefit schemes' evidence call. We would add here that we believe the Government must take proper account of the complexity of the UK pension regimes, including its legal frameworks, and carefully consult over a reasonable timeframe with all stakeholders before adopting a single consolidation proposal.

6. Do you think that the government should require all trustees to provide information to enable TPR to keep a register of all trustees?

Lay trustees: **Before further administrative requirements are added for lay trustees beyond those already required in the TPR Scheme Return document there needs to be careful consideration as to the purpose of such a register of trustees and what use it is intended to be put**.

It may appear logical that, because such registers are kept of charity trustees or company directors, that it would be helpful to make a similar listing available of lay pension scheme trustees. However, their respective responsibilities and obligations are quite different. There is a risk that lay trustees, who voluntarily take on the role and its responsibilities, might be deterred from taking on or continuing with the role if they were required to have extensive personal details registered. And, if the outcome of this evidence call, were to be that all lay trustees should be accredited (which we express reservations about in our answer to Q8) then, again, the accreditation processors would hold the required register without the need for a separate register of trustees.

We would suggest that thought would need to be given to the purpose of the register and use of the information held. For instance, would it be envisaged that it would be used to test the 'fit and properness' of lay trustees, monitor diversity and inclusion, or provide TPR with data to inform its supervisory work in relation to individual schemes (we note that TPR can of course already require trustees to provide a wide range of information).

Professional trustees: Our answer to question 11 below – where we indicate we are of the view there should be mandatory accreditation of Professional trustees – means that such information would be readily available from the accreditation processors, presently APPT and PMI, as to the details of all accredited Professional trustees. Presently, as professional trustees are not required to accredit, there appears to be an information gap that we would assume, from the case being made by TPR, is not filled by the large amount of data already collected in the present annual TPR Scheme Return.

7. If the government were to require this information, would it be best achieved through the scheme return or through a separate trustee return?

We strongly favour the current scheme return. The current return is more than able to be updated to collect this information if it does not require collection of any sensitive personal data. There is also a significant cost to schemes for completing returns which must be considered in asking them to complete a second return.

That said, we note that the appointment of a new individual or Firm as Trustee to a Master Trust requires completion of a notification form and confirmation of a Fit & Proper person at the time of appointment. If the objective of the register is to also act as a record of a new trustee meeting Fit & Proper person type requirements, then a separate trustee return may be warranted.

8. Do current accreditation frameworks provide a high enough bar to equip trustees who become accredited to properly fulfil their role, including in making investment decisions?

Lay trustees: The PMI's voluntary accreditation scheme for lay trustees seeking accreditation requires that they (in summary):

- Provide evidence of current Pension scheme appointments.
- Have successfully completed the latest Pensions Regulator's Trustee Toolkit.
- Have passed the Pensions Management Institute's Level 3 **Certificate in Pension Trusteeship (CPT) Unit 1** - Professional Trusteeship - a multiple-choice exam of 60 questions, lasting 90 minutes. Those already holding the **Award In Pension Trusteeship (APT)**, are exempt from sitting Unit 1, and it will count towards the final certificate as having been completed.
- Have passed the Pensions Management Institute's Level 3 **Certificate in Pension Trusteeship (CPT) Unit 2** - Soft Skills - a multiple-choice exam of 60 questions, lasting 90 minutes.
- Complete self-declaration statements.

If they are successful in their application to become an accredited lay trustee, to maintain their accredited status, they are required, on an annual basis to:

- Provide evidence of current trustee appointment(s).
- Complete 15 hours relevant continuing professional development (CPD) in the previous year, of which at least 10 must be structured (e.g. conferences, seminars or web sessions).
- Complete any new or updated modules in TPR's Trustee Toolkit.

We consider this voluntary accreditation scheme quite a high bar for lay trustees and this may explain why since its launch in 2021, based on the PMI Directory, only around 20 lay trustees have achieved accreditation, although no doubt more may be on the pathway. If it were mandatory it might well result in a significant proportion of voluntary lay trustees stepping down. Many are likely to be put off by the idea of sitting examinations (time commitment/not wanting to risk failure).

Professional trustees: The frameworks run by the Association of Professional Pension Trustees (APPT) and the Pensions Management Institute (PMI) to accredit professional trustees have been successful in accrediting close to 500 Professional trustees in the period since March 2020, when the frameworks were launched. Both of those frameworks followed from the development of **Standards for Professional Trustees of Occupational Pensions**, which were launched in March 2019.

Those Standards were the result of the work of the Professional Trustee Standards Working Group (PTSWG), established in 2017 by the professional trustee bodies across the pensions industry following the publication of the Pensions Regulator's (TPR) 21st Century Trusteeship and Governance discussion paper. Those represented on the Professional Trustee Standards Working Group (PTSWG) included Professional trustees from both large

and small firms and representatives from TPR, Pensions & Lifetime Savings Association (PLSA), The Association of Corporate Trustees (TACT) and Pensions Management Institute (PMI).

TPR's challenge to the professional trustee community was to establish a set of Standards for professional trustees and to put forward a system by which Professional trustees could be accredited to demonstrate their ongoing adoption of and continuing assessment against these Standards.

Under the current regulatory environment there is no legal requirement for professional trustees to be either accredited or be authorised by TPR or any other body. Compliance with Professional Standards and Accreditation is mandatory for APPT and PMI accredited members, but Professional trustees are not required to be members of APPT or PMI nor to be accredited.

Following the launch of Professional Standards in 2019 the PTSWG was disbanded and the responsibility for maintaining them passed to APPT. APPT developed its final accreditation process, which was launched in 2020.

The APPT accreditation process currently requires that applicants meet a range of requirements (see **below**). Applicants are subject to a review of their application form and other supporting papers by three reviewers, based at the accreditation processor, prior to an accreditation decision being made. During the review of each application many applicants have been required to provide additional information; to complete additional toolkit modules or, for example, have been requested to provide additional or alternative referees.

We examine below those areas that form the core elements of the professional trustee accreditation process:

Examination standards

One area often mentioned as highlighting the 'low bar' is the examination standards required of an accredited professional trustee. The Pensions Management Institute's Level 3 (broadly A-level equivalent) **Certificate in Pension Trusteeship (CPT) Unit 1** examination has been around for many years with minimal updates and is seen as a good general paper testing understanding of pensions including legislative and regulatory requirements and their application for trustees.

Accreditation needs prompted the introduction of the Pensions Management Institute's Level 3 **Certificate in Pension Trusteeship (CPT) Unit 2** - Soft Skills, introduced widely in 2020, which all APPT accredited professional trustees now have to complete successfully.

It is important to consider whether the coverage of the syllabus is set at too low a bar, or the examinations are too easy to pass. APPT's view, based on the experiences of our members is that the question banks would benefit from much more frequent change and update:

- First, to keep pace with rapidly changing regulatory requirements and practice
- And second, to prevent their getting into circulation amongst, for example, those that prepare individuals for examination.

PMI has more recently developed a Diploma in Pension Trusteeship, a Level 5 (broadly foundation degree level) examination, which is designed to be more challenging than the CPT Units 1 & 2. It is designed to test judgement when dealing

with complex pension issues and to go beyond awareness of technical knowledge. APPT has not determined whether a higher level of qualification would be beneficial, nor if it were whether the Diploma would be suitable. We note that PMI has also not chosen to include it in its accreditation framework to date and we understand take-up of the new Diploma has been limited.

APPT Council notes that many of those working as professional trustees have already passed examinations testing their abilities to a higher level, for instance those with actuarial, investment, pensions management, legal or accounting qualifications (estimated to be over half of the accredited professional trustee community). We are also conscious that the role of the trustee is not the same as that of an adviser; indeed, trustees are required to take advice from a number of experts. The importance of practical experience over exam-based testing should not be under-estimated and is crucial for undertaking professional trusteeship effectively.

Our 2023 Accreditation Review Recommendations are:

- **APPT to make further representations to PMI to review and update the syllabus and question banks of Certificate in Pension Trusteeship examinations Parts I and II.**

- **Consider further the merits of examination requirements to become an accredited professional trustee remaining at Level 3 or requiring a higher-level examination, at least for those without other relevant professional qualifications or extensive relevant and demonstrable experience.**

TPR Toolkit

Separately, APPT accredited professional trustees must successfully complete 12 modules set by **TPR's Development Toolkit** (5 core modules plus 4 aimed at DB trustees and 2 aimed at DC trustees plus the more recent 'pension scams' module). Accredited trustees are permitted to complete fewer modules if they elect to only take on either DB or DC appointments.

Here again, the argument is put forward that the standard required to successfully complete the modules is not as high as a professional trustee needs to effectively fulfil his or her role because the tests are also being set at a level to suit lay trustees and those in less senior roles within the pensions industry. However, APPT's view is that, **subject to updating and probably the addition of new modules**, the toolkit provides excellent background knowledge and a valuable foundation.

Our 2023 Accreditation Review Recommendations are:

- **We support the planned major overhaul of the Trustee Toolkit by TPR, or whatever replaces it, as the recognised source of minimum required trustee knowledge and understanding.**

Continuous Professional Development (CPD) and the Reflective Development Discussion

On CPD, the requirements set by the APPT accreditation scheme is an annual completion and evidencing of a minimum of 25-hours relevant CPD, of which 15-hours is recommended as 'structured'. Since the onset of the pandemic the ready availability of web based CPD opportunities has enhanced the widespread availability of structured CPD learning opportunities, with the APPT itself providing around 10 hours each year. The ready availability of structured CPD raises the possibility that the APPT could insist upon all accredited members completing at least, say, 20 hours structured CPD each year and introducing more stringent reporting of any unstructured CPD so that a learning outcome is recorded.

To date the emphasis has been on CPD hours undertaken, and as such it could be argued there is not sufficient evidence required or collected that the CPD selected has contributed to enhancing the skills (or filled the skill gaps) of the individual Member. It is to be hoped wider use of reflective development discussion will help to address this situation.

A voluntary process to conduct an annual reflective development discussion with another accredited professional trustee was introduced by APPT in its framework in 2021. This can be covered by a discussion on training and development included within a firm's annual appraisal or performance review process. APPT can provide support within Sole Trader and Small Firms group for those members that are not in firms. Analysis of the 2023 annual renewal returns showed good acceptance of the voluntary process - 52% of APPT accredited members had undertaken such a discussion in the previous 12 months. Council considers this process to be a worthwhile strengthening of the CPD process and intends that it becomes mandatory from 2024 membership renewal.

Our 2023 Accreditation Review Recommendations are:

- **The APPT accreditation scheme to supplement minimum CPD hours with a required annual *Reflective Development Discussion* with another accredited professional trustee should become mandatory from 2024.**
- **Retain the CPD requirement of 25 hours but limit the amount of unstructured CPD (such as private reading and research) to a maximum of 5 hours within the total and require members to document the learning outcome of all structured and unstructured CPD**.

Practical Experience

Accreditation requires that each applicant evidences practical experience either as a trustee for at least 3 years or showing at least 5 years' experience undertaking mainstream pensions work including, for example, investment, legal, covenant or regulatory roles or have held senior executive positions in business that can be seen to be relevant to those undertaking a professional pension trusteeship appointment.

This stated experience must be supported by two referees nominated by the applicant who have known the applicant and have experienced their work for at least two years and who are not current or former work colleagues.

Council has accepted that, with such a self-selection process, the referees selected will be supportive of the applicant, but it is not clear how an alternative accreditation process to identify a wider test of an applicant's work experience and capabilities could be achieved to make the assessment 'fairer' or less subjective. However, given the relatively small world of pensions, the view is that having two people put their names to a candidate is worthwhile and the step continues to provide a useful role in the accreditation process.

Other checks and declarations

The APPT accreditation process also requires that all applicants provide a copy of a basic Disclosure and Barring Service (DBS) check (or supply access to such a check) with the APPT guidelines clearly indicating that certain criminal convictions will exclude an applicant from either being a professional trustee or an accredited APPT professional trustee, or both.

The DBS check is followed up by an annual requirement at renewal to provide positive declarations that accredited Members have no prior or current legal or regulatory proceedings against them (with the Member giving a written assurance that they will notify APPT immediately if this changes).

There are further written 'Fit and Proper' declarations that all applicants and APPT accredited trustees must make (with declarations having to be repeated annually). These include observation of the Standards for Professional Trustees and, where they act as sole trustees, the APPT's PCST Code of Practice.

We have concluded that, within the current regulatory environment, the professional trustee accreditation framework has worked well since its inception three years ago. We believe it is pitched at an appropriate level and would remain broadly fit for purpose were a decision taken at some time in the future to make accreditation of professional trustees' mandatory.

There is some risk that without a regulatory requirement to be accredited, significant additional accreditation requirements could undermine the rationale for individuals to voluntarily accredit or to maintain their accreditation.

Important Note:

- **It is a measure of the success of self-regulation that there have been no disciplinary cases raised against accredited Members since the launch of the regime in 2020.**

The introduction of the APPTs **Professional Corporate Sole Trustee (PCST) Code of Practice** (see more in Q9 answer) has also been a success with that Code raising standards quite significantly where a PCST is appointed.

9. What proportion of your trustee board are accredited trustees?

Lay trustees: The PMI's voluntary accreditation process for lay trustees has only been in place for a short period of time (since 2021), and it is our understanding (at the time of writing) there are around 20 accredited lay trustees (based on the PMI Directory), with no doubt more on the pathway. Given the total number of lay trustees, which we understand may exceed 90,000, for most trustee boards the answer to this question must be 'Nil'.

That said, the broad range of skills, qualifications and experience of lay trustees is a vast resource that has underpinned the good governance of most UK trust-based schemes over the last century and beyond and should not be under-estimated. Careful consideration is needed before placing accreditation requirements upon voluntary trustees. **A likely outcome would be that the recruitment of lay trustees becomes even more difficult than it is at present**.

Professional trustees: Where schemes have an accredited Professional trustee appointed, they will be most usually the only accredited trustee on the board. A few larger schemes and Master Trusts will have two or more accredited Professional trustees on their boards, but they are very much in the minority overall.

However, because accreditation of Professional trustees is not mandatory and boards are similarly not required to have a Professional trustee within their number, we estimate that over half (c56% from other organisations' survey information) of all DB schemes have no accredited Professional trustees on their boards. In the main, these will be the smaller and mid-sized DB schemes.

Separately, there are now over 900 schemes (according to LCP 2023 research) that have a Sole Trustee appointment. Sole Trustee appointments where they are serviced by accredited Professional trustees working at the larger professional trustee firms will be served by a team of typically 2 to 4 named individuals at those firms to ensure the benefits of a consultative approach and diversity in decision-making. Initially, smaller schemes were attracted by the simpler governance and efficiencies of sole trusteeship in an environment where lay trustees (and notably active members) were often difficult to recruit, but increasingly larger schemes are moving in this direction, with a growth rate of 20% in new sole trusteeship appointments, year on year.

Over 70% of APPT accredited members now hold or co-hold one or more sole trusteeship appointments and they must observe the **Professional Corporate Sole Trustees Code (PCST)**, launched in 2021, which was introduced following consultations with stakeholders and the TPR.

10. If we required each scheme to have a certain proportion of accredited trustees, where should this bar be set? Should Master Trusts be required to have a greater proportion of accredited trustees than single-employer schemes?

Lay trustees: It is becoming increasingly difficult to find individuals who are prepared to act as a lay trustee. We have said in a previous answer that we do not believe a lay accreditation regime is at all practical, certainly in the near future.

Mandating a lay trustee accreditation regime and/or requiring one or more lay accredited trustees per scheme risks deterring those individuals from carrying out, or continuing to carry out, the trustee role and would seem to be a difficult ask without placing a greater onus on Sponsors to support one or more lay trustees with additional training, time, and financial resources. Rather than supporting lay trustee accreditation, we think it likely that more

sponsors will look to a sole trusteeship solution in the period ahead, particularly for schemes closed to new members and future accrual, to simplify governance arrangements.

Professional trustees: First, we would welcome accreditation becoming mandatory for all Professional trustees so those schemes appointing a professional can be sure of the observation of certain minimum standards.

Second, we favour a gradual move whereby schemes of a certain size or category are required to appoint a Professional trustee. We presently estimate just under a half of DB schemes have appointed a Professional trustee so there would be a considerable shortage of accredited trustees if it was decided to appoint one accredited trustee to every current UK pension scheme, including DC schemes of a certain size. We recommend that in consultation with TPR and industry, a decision is made on the most practical approach given the resources available, so government can set a phased introduction over a few years for the requirement for schemes to appoint at least one Professional trustee. That phasing should be flexible enough to take account of any significant consolidation of schemes over the next few years and might take account of different sizes and categories of schemes to be the priority candidates.

The greatest benefit comes from having one accredited professional trustee on a board, although in more complex situations we see examples where there are significant benefits from involvement of more than one, particularly where they have complimentary experiences (e.g. Investment and Pensions Management backgrounds)

We believe only accredited Professional trustees should take on Sole trusteeship appointments. Those accredited by APPT are required to observe the PCST Code referred to in the answer to Q9.

Typically, Master Trusts presently have boards where several trustees are either Professional trustees and/or have other trustees who have sought and achieved accreditation. However, many Master Trust boards have members with extensive business, financial and investment experience and qualifications that go beyond or are different from those available through the pension trustee accreditation processes. We caution against being overly prescriptive in relation to the composition of Master Trust boards, although a minimum of a third or a half who are accredited pension trustees or hold other relevant professional qualifications might be considered helpful, including in relation to the Chair.

11. Should there be more rigorous requirements for those acting in the capacity of a professional trustee? What sort of requirements/standards should professional trustees be meeting? Should there be mandatory accreditation?

As we have indicated in the answers to earlier questions, we have recently completed a review of the Standards for Professional Trustees of Occupational Pensions and APPT 2023 Accreditation Review. We concluded that for a voluntary regime the current requirements remain appropriate and are set at a level that should ensure that a growing number of Professional trustees are prepared to comply.

However, as we noted in the answer to Q10, **we do believe that accreditation should become mandatory to both protect scheme members and to ensure consistent high levels of scheme governance**.

If this decision were taken, it would allow for the accreditation regime to evolve in line with the pensions market and standards could evolve beyond those already achieved. This is something we have spoken to both the DWP and TPR about for several years and we await government legislation that would make Professional trustee accreditation mandatory.

12. How would you define a professional trustee for the purposes of legislating for all professional trustees to be accredited?

We believe the current TPR **definition of a professional trustees** feels appropriate and some important distinctions are made in that definition:

- That an individual does not need to be paid to be a professional trustee; and,
- That a professional trustee is someone who holds themselves out to a higher standard of care.

The definition would however require updating to make it clear that a Professional Pension trustee must be duly accredited by one of the current providers (APPT and PMI).

The role of advice

13. What are your observations on the external support trustees are given to make investment decisions, particularly in relation to unlisted equities?

Trustees already receive advice on their investment strategies, . with advisers providing advice which meets the agreed goals of the scheme. Those goals are usually agreed by both the Sponsor and Trustees and typically each party will take advice. Advice includes the positives and negatives (e.g. expected returns, volatility of asset class etc). Advisers will compare the characteristics with TPR's funding and other guidance and then position the options in the context of the scheme's longer-term goals.

However, the outcome of this approach usually leads DB trustees away from higher return/ higher risk/lower liquidity assets classes. Investment in productive finance and unlisted equites become an exception rather than a rule. This is particularly the case as DB scheme funding has improved and the membership profiles have become more mature.

Where schemes are on a buyout trajectory "re-risking" into unlisted equities is unlikely to be an option which is being sought.

There has also been a policy direction in recent years from both DWP and TPR for schemes to de-risk. Even the recent draft new DB funding code envisages schemes de-risking when they have reached significant maturity.

Advice on "new" asset classes tends to be provided on a "just in time" basis when trustees are considering changes to strategic asset allocations or appointment of managers for an asset class.

Given the large number of subject areas trustees need to grasp and the potential for turnover of trustees, provision of in-depth training on new asset classes more generally/at other times does not represent a good use of limited trustee time.

A key role of investment advisers is to put a new asset class into the context of the specific scheme circumstances (needs for liquidity, growth, capacity to exercise good oversight etc).

In APPT's experience they generally do a satisfactory job, although we do not have oversight of cases where professional trustees are not involved.

For DC schemes the investment considerations are typically somewhat different. Investment in illiquid assets is particularly challenging and this is more likely to be the cause of low levels of investment in unlisted equities than poor advice. Master trusts and larger own trust DC arrangements are likely to be both better advised and in a better position to take some steps towards investment in such assets. For all DC schemes finding funds of illiquid assets that can be provided through the DC administration platforms is operationally challenging.

Professional trustees appointed to schemes are able to identify their asset class knowledge gaps and find sources of information on new asset classes that go beyond the training provided by scheme investment advisers. There is plenty that is easily accessible and can be obtained at minimal or no cost.

14. What changes could be made, including to the regulatory environment, to improve trustee support in relation to unlisted equities?

In order trustee to make a decision to invest in unlisted equities it is important that there are investable products which meet the varied needs of schemes.

Investing in unlisted equities may open up new opportunities and be helpful in supporting the economy's growth agenda, but the nature of the asset class and potential geographical concentration brings risks, including greater concentration risk that trustees have typically accepted. Trustees would therefore need to understand what safeguards would be in place need to mitigate concentration risk so that the pension scheme does not put members' benefits at long-term risk. More guidance from Treasury or DWP would be needed to provide comfort and probably some safeguards considered.

It also seems likely that there would need to be further amendments made to the DB Funding Regulations allowing TPR to adapt their DB funding guidance to enable trustees to be confident in accepting additional risk. This does not need to be a wholesale change, but a small change could have a big effect.

Efforts to increase take up of unlisted equities are best focused on open schemes and other vehicles – e.g, the commercial and public consolidators mentioned in the wider consultation. Another possibility would be the insurers who will provide the ultimate landing place for many DB schemes in the next few years.

On the DC side, with such a heavy weighting of total assets being held by Master Trusts and occupational DC schemes with over 5,000 members (£134bn held by no more than 130 schemes), and with further consolidation measures being considered, it would seem likely that with a blend of guidance, incentives, safeguards and investable unlisted products, larger schemes will be in a position to divert a higher proportion of their investments in that direction. Encouraging DC schemes to give members more access to a wider set of investments that could improve their outcomes seems to be a better place for the Government to concentrate its attention. This would be subject to the availability of suitable funds and structures and appropriate mitigants for the additional risks involved, such as increased cost and illiquidity, taking into account that for many schemes a significant proportion of the assets relate to deferred member pots. It may be that appropriate mitigants cannot be found for smaller DC schemes.

15. To trustees: To what extent do trustees use investment consultants to support decisions around allocations to unlisted equities? Did they subsequently increase? Is there a deficiency of knowledge or expertise by investment consultants of these types of investments?

Investment consultants support trustees in their investment decision making by putting forward strategies which meet the objectives of the scheme. Such advice is required under law.

It is worth remembering that the Government has only recently suggested a higher allocation in unlisted equities and prior to that (including in the current draft DB Funding code) required trustees to de-risk and seek to remove the reliance on the sponsor's covenant. At present, after taking advice, the allocation to equities generally reduces rather than increases.

Trustees will consider investing in unlisted equities if there are investable products which meet their overall strategy – this has been a problem to date. Investment consultants will and do play a pivotal role in helping trustees understand the risks and opportunities that might exist. Very few DC platform providers makes available illiquid funds on their platforms for operational reasons.

16. What changes could be made to investment management to support pension scheme investment decision-making?

No comments.

17. To trustees: How does legal advice impact on your investment decisions? What is an acceptable level of tolerance for investment risk? Is there a culture of 'risk aversion'?

Legal advisers are used to advise on the contract documentation related to implementing investments and to ensure there are appropriate terms & conditions. They generally become involved after an in-principle decision has been made to invest in an asset class and with a particular asset manager. Legal advice has no impact on the asset allocation decisions unless there is a question around whether the investment is permitted by the trust's documentation (which it is typically given that investment powers tend to be widely drafted) or the due diligence or contracting process.

"Investment risk" is a multi-dimension risk (market volatility, liquidity, term structure/ return profile, credit, investment performance, investment manager failure…). How tolerance levels are set in relation to the investment risk interacts with other risks and characteristics of the pension scheme (covenant risk, membership profile, contribution payment profile, projects impacting scheme time horizon, membership preferences (particularly for DC schemes), trustee oversight capacity and tolerance for complexity …). Therefore, it is not possible to define a single acceptable risk tolerance for investment risk that could apply across all pension schemes.

Trustee responsibility is set out in the trust deed and rules of a scheme and is (usually) to ensure the pension fund is able to pay benefits as and when they fall due. This engenders a culture of risk management aimed at ensuring trustees can deliver on that responsibility rather than a culture of risk aversion. This risk management is overlaid by the need to satisfy

the pension regulations on scheme funding and regulatory guidance. If there is any risk aversion involved it is against acting in a way that would draw negative regulator attention, for example, by not staying within regulatory "guidance" and codes of practice.

Answering the question 'is there a culture of 'risk aversion?' one of our members, in respect of DB schemes, noted:

> *"In answering the question "Are trustees' risk averse?" the answer is "Yes" and for very good reasons. A DB scheme that has been well managed and well-funded over the years has no reason to make investments that increase risk – the impetus is usually quite the opposite with a desire to de-risk over time and I believe this pattern is very unlikely to change for well-funded schemes.*
>
> *I believe references to savers in the consultation (and indeed through communications from TPR in recent years) is very confusing and potentially misleading when it comes to DB schemes. Trustees are not charged with improving saver outcomes through increasing returns (as they might be in DC schemes); they are charged with ensuring member benefits are paid in full and the implication of this primary duty is that they should do this with the lowest risk that is consistent with that duty. There are some scenarios where higher return trumps lower risk but usually these are schemes that are not well supported by employer covenants and contributions. and they have little choice but to rely on higher risk/higher return assets as the only way the scheme will ever reach full funding (if it gets lucky)."*

Specifically in relation to DC schemes trustees make decisions in the best interest of members, recognising that a significant proportion of the scheme may constitute deferred member pots.

Barriers to trustee effectiveness

18. Is fiduciary duty a well-understood concept? Do current regulations and guidance support trustees to make investment decisions which seek higher returns for members? If not, what changes would be useful?

Our experience is that Professional trustees and lay trustees properly understand their fiduciary duty, which is to act in the best interests of members and scheme beneficiaries.

For DB trustees, fiduciary duty is often focused on protecting funding levels. For DC trustees there are lots of variables and investment returns are not the only consideration for trustees faced with the challenge of balancing risks, which include increased costs and insufficient liquidity.

As mentioned elsewhere legislation and regulation from DWP and guidance from TPR has been for DB schemes to aim to de-risk. Guidance at present does not differentiate between different types of schemes and many representations have been made to the Government to take into account individual circumstances such as open DB schemes. We refer to the **letter sent by the Chair of the Work & Pensions Select Committee to the Pensions Minister**, dated 19 July 2023, where this very point was made.

19. Do trustees currently make investment decisions in the long-term interests of pension savers? If not, what barriers are there to trustees making investment decisions in the long-term interests of savers?

Trustees generally make balanced decisions based on the wider regulatory framework they are operating within and the target and objectives for the Scheme. Sometimes these decisions are long-term and other times they are much shorter term as appropriate.

Overall, however the answer is, 'yes'. When designing an investment strategy, the trustees will work with its advisers and the Sponsor to understand the long-term plans for securing members benefits in full and design a strategy which helps achieve that plan. They will review that strategy on an ongoing basis to ensure that it remains appropriate and, where changes are needed, that they are made effectively and in full understanding of the risks involved.

More particularly, for DC schemes trustees aim to provide best possible outcomes for members in the longer-term. Inevitably, given the volatility of markets, there will be periods of poor performance, even when trustees follow the advice they are given by a range of experienced investment consultants. As already noted, there are many variables when it comes to investing.

A more particular challenge for DC trustees when considering default arrangements is having to consider the requirements of the membership as a whole which tends to coalesce around a small range of "average" member long term objectives and risk tolerance levels, The default investment strategy and any variations on the primary default are then designed accordingly. Inevitably any default investment strategy design is aimed at an average member and therefore resulting risk levels will be relatively high for some members and corresponding low for others, even where options for different risk level tolerance or long-term objective-based defaults are provided. Most DC schemes also provide self-select options for members who wish to invest to better meet their own individual risk tolerances and objectives.

20. How do trustees balance investment returns, costs and charges, and services when making decisions in the long-term interests of savers?

Trustee decisions are informed by the advice received from investment consultants.

Some investment consultants have a preference for low-cost passive investments, others have a view that more actively managed funds are more likely to achieve the best outcome. As with all investments, there are no guarantees and trustees must make the best decisions they can with the information available to them. Trustees are naturally prudent given their fiduciary duties.

Research supporting the theory of better long term net outperformance from more expensive actively managed funds verses cheaper passive funds is limited, particularly as the performance of actively managed funds can be highly idiosyncratic and manager dependent. You would expect half the assets invested in actively managed funds to outperform the market (i.e., represented by the passive fund of the same asset class) and the other half to underperform the market over any discrete measurement period.

Generally, trustees consider returns net of fees, but this does not mean the fee structure is irrelevant. In DC in particular there is usually a strong focus on costs, which can materially

erode long-term returns. When considering different funds, trustees will recognise that investment returns are unknown, but expenses are certain. This will usually mean that more weight is given to the expense metric rather than the investment return metric.

21. Do trustees' fiduciary duties discourage investment in alternative asset classes? If so, please explain with examples.

Given that Trustees are legal asset owners, investing on behalf of the scheme beneficiaries, their fiduciary duties under trust law and legislation and regulation tend to result in investing in asset classes which are commonly perceived to involve lower risk and therefore typically lower return.

Trustee will often conclude that there is less risk involved in investing in safer assets rather than riskier higher return assets. However, there will be circumstances where trustees can take a view that investing in alternative assets allows the scheme to further protect members benefits, for example because of diversification benefits as well as the potential for higher net returns. In that eventuality, alternative asset investments will be considered.

Again, as we have indicated elsewhere, the trustees of a DC scheme focusing on such issues as the potential for transfers out, member choices and flexibility in how and when benefits are taken may act quite differently to the trustees of DB arrangements where cashflows and the potential to wind-up at short notice may govern a more conservative approach to alternative asset classes.

22. Is the way in which trustees exercise their fiduciary duties preventing trustees from seeking the best returns for pension savers? If so, what is causing this?

Fiduciary duties will mean that trustee must consider downside risk before making a decision. The focus is or should be on risk-adjusted net returns. This is not the same as "best returns".

In our experience in relation to DC schemes Trustees are aware that members need good growth to deliver benefits or achieve members' retirement goals. Since the introduction of pensions freedom which has provided members with flexibility in how they take their retirement benefits can be taken from DC schemes has resulted in a progressive movement to retaining riskier assets in the default investment strategies. This reflects the longer-term time horizon and preferences of most DC members to move into drawdown options rather than having to buy an annuity.

That said, trustees of DC schemes are mindful that many members may be concerned by large falls in their investments in the short term. Member communication and education is therefore important with long-term perspectives can be difficult to convey and for members to be able to engage with.

Our experience is that, in any amendments to DC default strategies, trustees are aiming to find a balance between potential higher long term returns and any increases in investment charges with value for member being a key consideration.

Scheme size and the investment options available to members are also a core factor in choosing investments. Minimum investment size requirements, particularly into some illiquid asset funds can make investment into such funds impractical.

Another influence has been the costs and charges transparency initiative. However, accessing this information comes at a price to each scheme as investment consultants or other advisers generally charge trustees for this information and not all trustee boards are willing to pay those fees. At the same time not all investment consultants use the client base information they have and the influence they have over investment managers from being a gatekeeper in making recommendations to trustees to assist trustees to negotiate lower charges.

For DB schemes, trustees aim to ensure that members receive 100% of their pension benefits as defined by the governing trust deed. As the scheme funding position improves, they look to de-risk investment strategies to secure the members position, protect the sponsor from having to make deficit recovery contributions and reduce reliance on the employer covenant. This is the approach which the DWP and TPR have long asked trustees to take.

23. Do those actors who have most influence on advice to trustees on long-term investment decisions experience any challenges or barriers in provision of their advice on illiquid assets? If so, what would unblock this?

No comment.

24. Would trustees find it helpful if they received more direction from regulators when assessing their investment decision making? In addition to our work on Value for Money we are also interested in whether the advice for trustees provided by regulators via training and guidance supports our objective to shift the focus from cost to value?

We are not sure more trustee guidance is what is needed. We believe it is reasonable for trustees to be able to rely on their investment advisers, so it would be the investment adviser who should be introducing viable new ideas. Trustees are there to challenge advisers and make decisions in the wider context of the scheme, not in relation to investment in isolation.

Most investment consultants frequently present new ideas to trustees.

Each scheme is different and so must consider each investment decision on its own merits for that scheme.

Many would argue that a shift of focus from cost to value is over-simplistic. In our experience trustees have not generally ignored value for the sake of cost. There have been and continue to be instances of charging structures that favour the investment manager and are wholly disproportionate to value. It is the job of advisers and trustees to consider the balance of return, risk and charging structure and make considered decisions.

Downward pressure on charges is important and regulation has played its part in this as seen in the DC default charge cap.

25. Do lay trustees have enough time and support to perform their duties effectively? Do professional trustees? If not, what changes would support this?

Lay trustees: The role of a trustee is to provide oversight and trustees should therefore not be expected to become experts in every area. Trustees should reasonably be able to use and rely on the advice of advisers Trustees need to know enough to be able to challenge that the advice being given is appropriate in the circumstances.

Many lay trustees are invariably performing the trustee role either alongside other roles (their day job) or in retirement. Their time is limited, and they are often not being paid to be a trustee. We need to also recognise that as pension solutions, governance structures and issues become more complex the level of knowledge and understanding and time needed to act as a trustee increases significantly, which will make it difficult for many individuals to find the time to take on trustee appointments.

For lay trustees it can very much depend on the scheme and sponsor. There are some excellent trustees who spend hours on their scheme each week. There are others who have less time to spend on trustee duties. However, in both cases this input may not be disproportionate to the needs of the scheme or members. **The willingness of Sponsors to provide adequate time and resources is also relevant. It may be that some greater government support for requirements for time off for trustee duties are now warranted**. With more trustee working taking place outside of formal trustee meetings, particularly since the pandemic, the tendency to link time provided to lay trustees to formal meeting attendance needs to be reconsidered.

To improve governance and free up agenda time for key strategic discussions, there also needs to be less “box ticking” regulatory requirements, especially for smaller schemes where there is limited governance budget.

Yes, trustees need to absolutely consider all risks carefully, but they must also be proportionate in the way they act and ensure that they are able to focus on the key decisions and oversight which has most positive impact on member outcomes.

Professional trustees: Professional trustees do generally have sufficient time and support, although they have to take care that their ability to spend time on scheme matters is not unduly constrained by fee/budget arrangements.

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