Spotlight on Pensions
PRESENTS
Le Grand View

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Climates Changing

Pension scheme trustees are facing the prospect of a new wave of pressure when they return, hopefully refreshed, from their summer breaks.

A new consultation "The Future of Trusteeship and Governance" from The Pensions Regulator (TPR) indicates a change to the regulatory climate, ramping up pressure on trustees to comply with TPR's governance expectations from existing regulations and hints at a stricter regime to follow.

TPR continues to be concerned about governance standards, particularly in smaller schemes. Its research shows a substantial disparity between the trusteeship standards in larger schemes and smaller ones. Given the increased focus on some larger schemes, with one-to-one monitoring a reality for 25 of them and more to follow, it is perhaps unsurprising that TPR is also turning its attention to smaller schemes to try to narrow that gap.

It is particularly focusing on "a subset of disengaged trustees that are either unable or unwilling to take action to improve scheme governance", but the consultation document makes clear that this is the start of a two-year push to raise standards across the board. TPR intends to "proactively drive up a range of specific governance and administration standards through a number of regulatory initiatives, including those on investment governance, record-keeping and prompt and accurate financial transactions". This will be followed up with "further initiatives on costs and charges, trustee knowledge and understanding, and public service scheme administration".

More from the professionals

Although higher standards will be expected from all trustees, there are additional pressures on professionals, in the form of a TPR-supported new accreditation framework due later this year from the Association of Professional Trustees and the Pensions Management Institute. This is an important piece in the emerging new governance jigsaw.

It is a declared "aspiration" of TPR to see "an accredited professional trustee on every board in the future". The consultation paper goes further and controversially asks respondents for views on whether that should become a mandatory requirement. Time will tell what the response from schemes, sponsors and industry will be, but anecdotally there is a significant body of opposition. Even with a widespread take-up of the (voluntary) professional accreditation regime, a requirement for a professional for every scheme implies a significant growth in the number of professionals required. This larger cohort will place a greater strain on an accreditation framework.

Requiring a professional on each trustee board will also increase costs, at which many sponsors will baulk. For a number of them, the reaction will be to wind up the scheme, or enter into a consolidation arrangement, which TPR is also encouraging, to reduce scheme numbers and associated regulatory costs and effort. However, amongst the cohort of employers who continue to believe in providing defined benefit pensions for their employees but who are struggling to do so, there may be an increase in the numbers moving to a defined contribution offering for future service, and in the number of enhanced transfer value offers to reduce accrued defined benefit obligations.

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Increased diversity

The consultation paper also makes clear TPR's belief in the benefits of a diverse trustee board. This, TPR suggests, would require a group of trustees from a range of backgrounds, which it is hoped would bring different perspectives, experience and expertise to the board, tailored to the circumstances of the scheme's membership and of the sponsor. Admirable though this is, there are nevertheless valid questions to ask around the benefits to be gained in practice from encouraged/enforced diversity, including whether that leads to a lowering of standards in an attempt to meet quota targets. There is also an implied conflict between a policy to encourage trustee board diversity to achieve better focus on the circumstances of a scheme's participants, and the consolidation of schemes, which dilutes the relationship between the members, sponsors and those charged with governing the scheme.

Addressing the other climate change

An element of trustee responsibility attracting growing attention from regulators is the response to world climate change. This has been identified as a specific threat to the future financial wellbeing of current workers. Pension scheme trustees collectively have a huge potential influence on such issues as carbon emissions through their decisions over investment of their extensive funds. Given the growing focus on this issue, the largest carbon-producing businesses face an uncertain future, with direct implications for their investors' wealth as well as the more general impact on the planet.

Recognising this, the largest Dutch pension funds, banks, insurers and asset managers with collectively €800bn of assets have signed a national climate agreement, pledging to report on carbon emissions associated with those assets from 2020; by 2022 they must make clear how they will reduce those emissions.

In the UK, disclosure requirements effective from October require trustees to reveal how their investment strategies consider financially-material ESG risks, including climate change. Moving up a level, an industry working group has been established by the Government and TPR to develop guidance for schemes on reporting in line with recommendations of the Task Force on Climate-related Financial Disclosures, as part of the Government's Green Finance Strategy published in July.

The output from these initiatives will no doubt add to the responsibilities placed upon trustee boards. It will also shape the constitution of the "optimum" board. This is just one example of new issues that will continue to arise and whose impact will need to be factored in to future regulatory approaches.

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Heavy responsibility

We should all be concerned about poor scheme governance standards, and about wide discrepancies between standards experienced by members of the best and worst schemes. The interrelationship between the many aspects of the modern pension scheme means that effective regulation is always going to be a challenge. In a kind of bizarre game of "whack a mole", tightening rules to squash one issue leads to another popping up elsewhere. The knack, as always, is achieving acceptable standards of governance whilst not adversely impacting the very benefits that the regulation is trying to protect.

In a constantly-changing world, achieving the optimum balance also involves hitting a continually-moving target. The more prescriptive the rules imposed, the more difficult it becomes to achieve that outcome.

The game is entering a new, and critical, phase. Time will tell whether the new balance that results from the new initiatives will be seen overall to have improved the pension benefits of UK workers. The responsibility to get this right is a heavy one, and it is important that the industry plays its part.