
Synopsis of responses to the Pensions Authority's consultation on financial management guidelines for defined benefit schemes

Introduction

The Pensions Authority published a consultation paper on financial management guidelines for defined benefit schemes on 23 July 2014. The proposed guidelines set out what practices the Authority expects trustees to follow in order to understand and manage the funding and investment of their defined benefit scheme. The consultation paper set out specific questions on all aspects of the proposed guidelines and sought responses by 30 September 2014 from trustees, providers, managers, advisers and other interested stakeholders.

During the consultation period, the Authority hosted a Public Consultation Forum to discuss the matters raised in the consultation paper. Presentations were given by the Pensions Regulator and the Actuarial Advisor to the Pensions Authority, followed by an open forum for attendees to give their views or ask questions. Seventy four people registered to attend the event.

The Authority has received a total of 19 written submissions in response to the consultation, 3 of which have come from individuals and 16 from organisations. The consultation document posed 6 questions and the responses summarised below reflect the main points made and a range of suggestions offered to deal with the questions raised. It is noted that some of the responses dealt with issues outside the scope of the guidelines, e.g. communications with members or legal obligations of employers.

This document is a synopsis of the responses the Authority received to the consultation phase of this process and does not cover all of the points made.

Detailed consideration will be given to all the points made in the submissions to further inform the Authority's views before the final version of the financial management guidelines are published.

Synopsis of responses

1. Have you suggestions on how we could improve the guidelines?

There was broad agreement that the proposed guidelines should help as a practical guide to what trustees should do to understand the financial position of their scheme and to manage their scheme's funding and investment. While acknowledging that the reasons put forward in the guidelines certainly contributed to some schemes failing to meet the funding standard, it was commented that the legislative requirements and the introduction of the pensions levy were also contributing factors to the problems that arose. It was suggested that the guidelines, while useful, cannot fully protect schemes from extreme conditions.

It was remarked that trustees of most schemes are already operating to higher standards than those suggested in the guidelines and that the guidelines should be regarded as minimum requirements for trustees. It was suggested that it should be made clear that the purpose of the guidelines is to improve risk management and encourage strategic thinking, rather than to produce paperwork and increase the cost of compliance, and that it would be useful to have a layered approach to risk management setting out what would be regarded as minimum acceptable practice, good practice, and best practice. It was proposed that the guidelines should be made mandatory with a suitable lead-in period.

Many positive and constructive suggestions, in particular relating to the content of the guidelines, were offered under this heading and some of these are outlined in more detail as follows. Respondents commented that:-

- greater emphasis should be placed on the need for trustees to have a full understanding of their powers under the scheme rules, especially in the areas of their powers to invest, to appoint advisers, and their powers relating to the contribution provisions of their scheme. Trustees should be specifically aware of any restrictions or consents that may be set down in the rules;
- trustees should be clear on the extent to which they need to have the employer's consent before they appoint advisers and administrators. Rather than the proposal to have a written agreement between the trustees and sponsoring employers concerning the trustees' freedom to incur costs, it would be more appropriate for trustees to be aware of what is prescribed in the trust deed and rules in this regard, and to obtain the employer's consent where necessary;
- greater emphasis should be placed on the need for trustees, of larger schemes in particular, to keep membership details up to date, especially that relating to the continued existence of pensioners, and also on the need for trustees to keep scheme data up to date for the purpose of empowering them to make real-time decisions;
- the need to have appropriate Service Level Agreements in place with each party to whom functions are delegated, as well as the fact that these should be reviewed at regular intervals, should be included in the guidelines;

- it should be stressed that trustees should ensure that their investment adviser has the expertise to advise in the context of all DB funding matters. It was suggested as good practice that investment and actuarial advice be sought from separate independent advisers;
- any potential or perceived conflicts of interests between the trustees and their advisers should be identified and recorded, and they should be reviewed annually. In relation to advisers, it was suggested that it would be impractical and inappropriate for any advisor to have to confirm to the trustees that there is no conflict of interest, as is stated in the draft guidelines.

2. Does the level of guidance included in the guidelines provide sufficient detail to assist trustees in the financial management of their schemes? Do the guidelines include sufficient practical guidance on the standards of financial management of DB schemes that the Authority expects? If not, can you suggest additional guidance?

Some of the suggestions made in response to Q1 above apply equally to this question.

It was generally thought that the level of guidance included in the guidelines provides some detail to assist trustees in the financial management of their schemes. In terms of practical guidance, it was felt that some of the deadlines proposed in the guidelines should be changed to allow for either a more frequent review by trustees of their tasks, or to give the trustees more time to get more solid information, e.g., the trustees should carry out a review of the asset values and investment performance more frequently than annually for larger schemes in particular, or where a scheme is not meeting the funding standard; they should have two months after the scheme year end to obtain scheme asset values, particularly in relation to illiquid assets.

It was also suggested that trustees should be required to review the assets and liabilities of their scheme at the same time and that an estimate of liabilities should be specified rather than accurate figures that would involve more time and expense for no extra benefit. Another suggestion was that trustees should agree on a reasonable time each year for a funding update rather than defining it by reference to the renewal date.

It was proposed that trustees should be clear in relation to the determination of contribution rates and their powers in this regard, and because generally there are two mechanisms under which contributions to DB schemes are determined, i.e., the provisions of a funding valuation and the provisions of a funding proposal, that funding guidance should be consistent with the requirements to produce these documents and should not introduce any extraneous requirements that would add further to costs.

It was felt that, rather than saying that regular scheduled trustee meetings should be held, it would be better to specify a minimum number.

It was thought that the guidelines should suggest that a meaningful improvement in written statements of investment policy principles (SIPPs) was required from trustees because it was viewed that only the minimum of information is provided in these statements at present. There were conflicting views as to whether the SIPPs should be prepared for all schemes and included in all annual reports, or whether the current requirement should remain.

It was suggested that any published guidelines should be updated regularly to reflect best practice which continually evolves.

3. Is the approach to risk management set out in the guidelines useful? If not, why not? Do you have an alternative approach to risk management for DB schemes?

There was broad agreement that the approach to risk management set out in the guidelines is useful. No clear alternative approach was put forward in the submissions. It was remarked that the approach should not be just a 'tick-box' approach and that trustee should be encouraged to excel in this area to allow them to better manage the solvency and investment of assets. It was proposed that greater emphasis should be put on the need for trustees to focus on the sponsoring employer rather than on the employer group because the financial resources available may be quite different in each case.

Some suggested that the risks identified should be expanded to include, among others:-

- poor governance;
- the ability of the sponsoring employer to meet its contribution obligations over the short and longer term;
- the risk or likelihood that the sponsoring employer does not have the financial capacity to accommodate a future contribution increase;
- the level of risk being taken on by different cohorts of member, e.g. by the remaining active members as members retire;
- inflation and currency risk;
- concentration of assets/self-investment risk;
- demographic risk;
- scheme administration such as inaccurate member data/calculation errors.

A suggestion was made that the risks could be categorised as those over which the trustees have no control (the first three of the five listed in the guidelines as the greatest risks, i.e. longevity increasing by more than expected, investment losses or lower than anticipated returns, liabilities increasing because of falling interest rates) and those over which trustees have control (the last two listed, i.e. the sponsoring employer being unable or unwilling to pay the necessary contribution rate, scheme liabilities increasing because of unexpected growth in member earnings), and that it might be appropriate, in the context of managing these risks, for the trustees to have an objective of reducing the uncontrollable aspects of the first three risks in order to

provide financial certainty to those who fund schemes and to those who benefit from the schemes. There was a view expressed that the requirements/objectives of how risk likelihood could be assessed should be further clarified because it was felt that this cannot be done in every case due to the likelihood of future mortality improvements continuing to increase or fall, or because the cost of assessing the strength of an employer covenant being prohibitive.

It was suggested that costs should be defined to include both direct and indirect costs such as commissions, and that these costs should be monitored by trustees as they are incurred.

4. Do you agree that we have set out clearly what actions are expected of trustees in relation to risk management and internal controls?

Some of the suggestions made in response to Qs1, 2 and 6 apply equally to this question.

Some suggested that the actions expected of trustees were clear, while others, in accepting that the actions reflect the practical difficulties faced by trustees, and the fact that the guidelines are set out within narrowly defined areas, considered that the actions were somewhat vague. It was suggested that greater direction and detail be provided in this area, particularly in relation to investment governance.

There was a view that trustees of larger more complex schemes may need to put in place additional internal controls in order to manage the scheme in accordance with the legislation and the scheme rules.

Another view was that trustees should take legal advice when undertaking the analysis of the employer's funding covenant and contribution obligations, and in relation to whether the employer can terminate contributions to the scheme without prior notice to the trustees.

In terms of internal controls, it was suggested that trustees should have a governance framework document/modus operandi in place which would set down clearly their governance practices, e.g.

- appointment of chairperson/secretary
- timing of meetings
- sample agenda
- selection/reselection of trustees
- communications policy
- clearly defined policy statement covering matters such as funding and investment policy
- risk management
- management of cash flows and costs.

It was also proposed that a conflicts protocol be put in place to deal with any potential conflicts of interests.

It was suggested that trustees should be more open and transparent in their management of financial risks, and that they should be compelled to write to all scheme beneficiaries annually to advise on the risks faced by DB schemes in general, and their own scheme in particular.

5. The Authority is considering whether to prepare practical tools such as sample risk matrices and case studies. Would you find that useful? Would you be prepared to participate in a working group to prepare such tools?

There was universal agreement that it would be useful to have sample risk matrices and case studies available as practical tools to assist trustees, particularly new trustees, and most said they would be prepared to participate in a working group to prepare such tools. It was thought that these tools would be useful for trustees of smaller DB schemes and could potentially encourage useful conversations between trustees and their advisers, and could help trustees in challenging the advice proffered by their advisers. It was suggested that the use of case studies, and sample questions on specific issues, as a means of applying the guidelines to real life situations, such as discussion with their employers about the sustainability of the existing contribution rate, would allow trustees to see how the guidelines are intended to operate in practice. It was remarked that it would help if sample tools could be tested by a 'test group' of trustees in advance of they being finalised.

A suggestion was made that the Authority should promote the concept, and prepare a specimen copy, of a statement of funding principles that would formally document items such as the scheme's funding targets, surplus/deficit spreading policy, assessment of employer covenant.

6. Are there any issues not mentioned in the guidelines which should be?

There was a diverse range of suggestions offered on issues not mentioned in the guidelines. Some suggested that trustee communication with members, including those in receipt of benefits, was not adequate, and that this should be addressed in the form of Annual General Meetings at which members could attend, and at which advisors would be available to answer members' questions. There was specific mention of a requirement for trustees to meet with pensioner representatives outside of an AGM, should exceptional circumstances arise.

Others suggested that:-

- trustees should be required to carry out a formal assessment of the sponsoring employer covenant, to allow the trustees ascertain how willing and able the employer is to maintain/increase the contribution rate needed to pay the benefit, and to gauge the implications for the future financial risks in the scheme;



- the running cost incurred by the scheme's sponsoring employer, i.e., cost of the various pensions advisors and consultants, should be available to the trustees before they enter into discussions with the employer on the scheme's funding position;
- the relationship between the trustees and the employer in terms of the trustees' contribution powers and the employer's termination powers as a risk factor should be properly assessed by the trustees;
- the timely preparation of Pension Scheme Accounts and the audit of these accounts should be emphasised along with the need for trustees to have oversight of the controls in place and the operation of these controls throughout the scheme's financial year, particularly in relation to larger schemes;
- it should be a requirement for trustees to communicate clearly to members, using realistic assumptions, details of the investment returns required to pay the benefits promised, for a given level of contributions, as well as the risks involved which could result in the benefits having to be reduced;
- a section outlining the duties and responsibilities of employers participating in DB schemes should be included in the guidelines that would outline, in particular, their responsibility in the area of scheme funding;
- trustee boards should have a skilled chairperson, independent of the sponsoring employer, who could offer leadership and guidance based on experience, and who would ensure that meetings are focussed to cover all aspects of the administration of the scheme. It would be desirable to have a professional trustee appointed for every scheme, or, given that scheme investment is such a complex area, to have an investment sub-committee with the appropriate skills in place;
- trustees, particularly new trustees, should be made aware of the requirements to keep themselves trained and up to date with pensions developments and should be advised of the information that is available to them;
- trustee training courses should be adapted to include an advanced module on risk management that would encourage trustees to adopt a more proactive approach to risk management;
- anti-fraud programmes/monitoring should be included as a governance practice;
- the Trustee Handbook should be updated to include more supportive information, particularly in the area of financial management.