
The consultation follows on from the Regulator’s work a couple of years ago on trusteeship under the 21st century trusteeship banner and continues with some of the themes identified by the Regulator as part of that exercise. The three main themes of this consultation are:

- Trustee Knowledge and understanding
- Scheme governance and effective decision making
- Consolidation of defined contribution schemes.

Trustees need to be aware of developments in this area and consider whether there are any improvements they could make to address the Regulator’s concerns. We will provide another update on the likely impact on trustee boards when the Regulator publishes its response to the consultation.

Key points for trustees to consider in relation to how the consultation might impact them

1 Trustee Knowledge and Understanding (TKU)

The Regulator intends to revisit the TKU code and make it simpler, clearer and easier for the Code to support good governance. However, the consultation also questions whether trustees should be required to demonstrate a minimum level of TKU and ongoing learning.
2 Scheme Governance and effective decision making

The Regulator wants more diversity on trustee boards both in terms of backgrounds, skills and expertise. The consultation sought views on how this might be achieved. The Regulator also sought views on whether all trustee boards should be required to have at least one professional trustee.

3 Consolidation of Defined Contribution Pension Schemes

Schemes that cannot meet the expected governance standards will be encouraged to consolidate. The alternative will be enforcement action or winding-up.

What is driving the consultation?

The Regulator's aim is to reduce the number of poorly governed pension schemes. All savers should be in well run schemes that deliver good value.

The Regulator is concerned that there is a clear disparity between the experiences of savers in well run and badly run schemes.

Ultimately if trustees cannot meet the standards the Regulator expects, its view is that those schemes should wind-up and consolidate savers into better run schemes. The consultation focuses on consolidation of defined contribution schemes but also confirms that the Regulator is working with the Department for Work and Pensions to find a solution to support defined benefit scheme consolidation. The Regulator's long term goal is to have all savers in schemes that have excellent standards of governance and that deliver good value. This will mean fewer but better governed schemes.

21st century trusteeship

The consultation follows on from the Regulator's work in 2017/2018 on trusteeship under the 21st century trusteeship banner. This campaign also focused on raising standards of governance and highlighted the Regulator's concern that some trustee boards of small and medium sized schemes were not meeting the required standards of governance.

As part of the campaign the Regulator also focused on skilled, engaged, diverse boards; training and skills; and expectations and standards of care for professional trustees.
The consultation

Trustee knowledge and understanding

The Regulator plans to revisit the TKU code, using the 21st century trusteeship expectations as a starting point for a new minimum standard of trustee knowledge. The revised code is intended to make it "simpler, clearer and easier" for TKU-related content to support good governance.

The consultation seeks views on whether:

- a legal requirement should be brought in for trustees to demonstrate how they have acquired a minimum standard of knowledge and understanding;
- the law should require trustees to be able to demonstrate a minimum level of ongoing learning;
- there should be a higher expectation of knowledge for professional trustees.

Where schemes have trustees that are "persistently unable or unwilling to meet the standards we expect", the Regulator will actively encourage consolidation.

Our experience would indicate that the expectations set out in the 21st century trusteeship campaign could be a good starting point for defining a minimum standard for trustee knowledge. However, it may also be helpful to include aspects of the relationship between the Trustees and the sponsor, where schemes are defined benefit in nature, to enable Trustees to be able to understand sponsor covenant and associated risks as well as the legitimate needs of the sponsor and the challenges it faces.

What is less clear is whether there needs to be legislative change so trustees can demonstrate how they have acquired a minimum level of TKU or to introduce a minimum level of ongoing learning. Our experience is that the majority of trustee boards undertake training and keep records of that training. Imposing further legal requirements risks discouraging lay trustees from the role. Many schemes already struggle to recruit such trustees. The Regulator's approach also focusses on individuals whereas it is the knowledge of the board as a whole and the way in which professional advisers are engaged to supplement that knowledge that will impact the governance of a scheme.

Clarity from the Regulator on what it expects of trustees, both individually and as a board would be welcome, rather than imposing an additional compliance burden on all schemes to address a concern that relates to a minority.
In relation to the standards to be expected of professional trustees, as professionals who are paid for their time and present themselves as having a certain level of expertise and knowledge, they should have higher levels of TKU. However, it is important to distinguish between professional trustees and independent trustees. The latter may not be acting as professionals but may provide other valuable skills such as those required to run an effective meeting as Chair or to nurture the relationship with the sponsor.

Scheme governance for effective decision-making

The Regulator intends to increase its regulatory activity, including thematic reviews over the next two years. It views effective trusteeship and good governance as the bedrock of any well-run scheme.

Proposals to improve trusteeship and governance include:

- **Trustee diversity**: the Regulator wants to encourage diversity on trustee boards to include varying backgrounds, skills and different types of expertise. The consultation asks how diversity on pension scheme boards can be improved;
- **Mandatory professional trustees**: the Regulator seeks views on whether it is desirable eventually for schemes to be required to engage a professional trustee. Its view is that most schemes would benefit from a professional trustee on their board because those trustees are held to a higher standard and bring relevant wider experience to trustee boards; and
- **Effectiveness of sole trustees**: the Regulator is also asking for views on the use of sole trustees, including sole trustee directors or those acting on behalf of a professional trustee firm. It questions whether sole trustees are able to run pension schemes appropriately.

The Regulator is seeking evidence to support its concern that sole trustees are sometimes used by scheme sponsors of defined benefit schemes in the belief that it will allow them to negotiate an employer-friendly funding arrangement. Safeguards that could guard against this include introducing higher governance standards for sole trustees and closer scrutiny of the management of conflicts of interest.

Although reporting on diversity within trustee boards and the steps that are being taken to promote diversity (perhaps in the Chair’s statement) would encourage schemes to focus on this area, it needs to be recognised that there may be obstacles to individual schemes making progress. Limited financial resources would be one obstacle, but the constitution
of the scheme itself may be another. Some mature, frozen defined benefit schemes may not have a very diverse membership and so a board that reflects that membership may not be diverse from a demographic perspective. "Diverse" should be given its broadest meaning to cover demographics but also skills and experience and it should be recognised that in some cases improving diversity will be a long term aim.

Mandatory appointment of professional trustees may also be a step too far. Many boards without such a trustee have high levels of TKU, engage appropriately with their advisers and do an excellent job. However trustee boards should be encouraged to give thought as to whether such an appointment would be beneficial to them as there is no doubt such appointments can be positive, especially for smaller schemes.

Our experience is that sole trusteeships can be very effective and efficient, particularly for small schemes, provided that there is protection against abuse of this board structure. Any concerns could be addressed by:

- ensuring the right standards for professional trustees so the Regulator can make sure professional trustees meet high standards of integrity and are reputable;
- seeking additional written explanation from sole trustees when submitting valuations to the Regulator; and
- requiring appropriate "shadow" trustee procedures within a sole trustee's organisations to ensure oversight.

**Consolidation of Defined Contribution Schemes**

The Regulator stresses that it will seek to facilitate and encourage scheme consolidation as a way of supporting efficiency and "closing the quality gap" for defined contribution schemes that do not meet the expected governance standards. Schemes that are unable to meet the expected standards of trusteeship and governance will need to improve or they will face enforcement action or be actively encouraged to wind up. This is in line with the Government’s consultation that looked at encouraging smaller defined contribution schemes to consolidate.

The consultation looks at how consolidation can be supported and achieved and considers the following initiatives:

- Requiring trustees of "underperforming" schemes to consider if they offer members value for money or whether they would be better off in a larger scheme. The Regulator is supportive of the Government’s proposal that schemes carry out a regular
assessment of "value for money". It considers that this should be done at least annually, in contrast with the Government's proposal that this might be done every three years.

- The Regulator proposed to make further changes to its defined contribution winding-up guidance to address some of the perceived barriers expressed by trustee of smaller schemes. This is intended to help trustees to navigate their way through the wind-up journey.
- The Regulator is also investigating whether there is a way to circumvent the restriction on bulk transfers without members' consent where there is an element of a guarantee or a promise, such as guaranteed annuity rates (GAR).

Guarantees in defined contribution schemes are currently barriers to consolidation. This is a complex area and guidance from the Regulator would add clarity in relation to what the Regulator's expectations are and what it regards as the priority issues, as well as ensuring consistency of approach in safeguarding member's benefits. It could also help identify issues that may need regulatory intervention or easements. However, guidance alone will not remove the current barriers to consolidation and some regulatory intervention is likely to be required.

**What happens next?**

The consultation closed on 24th September 2019 and we do not expect a response from the Regulator until the new year. In the meantime trustees and scheme sponsors should make sure they are aware of the Regulator's views and proposals and give some thought to the areas of concern the Regulator raises. The board could consider (this is not an exhaustive list):

- How they assess and record their levels of TKU both individually and as a board. Could any improvements be made in this area that would address the concerns expressed by the Regulator in the consultation?
- The make-up of the trustee board. Is it as diverse as it could be? Is there a professional trustee and if not, would it improve the scheme's governance if there were?
- If the scheme is defined contribution in nature, would it be a suitable candidate for consolidation and is this something the sponsor would support?

How the Regulator will move these issues forward will become clearer once it has considered the industry's views as expressed in the responses it received to the consultation and its formal response is published.

If you wish to find out more, please contact us.
Related  Pensions, Defined Contribution Pensions

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