# Pension trustee skills, capability, and culture: a call for evidence

## IGG Response

***September 2023***

## About IGG

Independent Governance Group (IGG) specialises in, and is one of the leading providers of, professional pension trusteeship, scheme governance and pensions managerial services in the UK. We were created in 2023 following the merger of two long-standing professional pension trustee firms, Independent Trustee Services and Ross Trustees and have 140 members of staff. Our multi-disciplinary team includes wide-ranging expertise in all areas. Investment specialists, actuaries, analysts, covenant and restructuring experts, pensions managers, project managers and scheme secretaries deliver value through collective excellence and a fully integrated, team-based approach.

IGG holds a variety of appointments with occupational defined benefit (DB) and defined contribution (DC) schemes and master trusts. Including DC Master Trusts, the total value of all schemes we support, across 460 appointments, is more than £350bn.

## Mansion House reforms

IGG welcomes the core principles set out in the Chancellor's Mansion House speech and his ambition to promote economic growth in the UK through innovation and competition in the financial services and pensions sectors. We broadly support the attempt to address some of the difficult economic issues present in the UK through more innovative use of pension scheme assets. However, we want to work with the Government to ensure that there is an appropriate framework for achieving this with clear and proportionate regulatory supervision in place. By working with industry on the practical application of proposed reforms, Government can mitigate against any unintended consequences, such as a reduction in the likelihood of members receiving their pension benefits.

We believe there should be further consideration as to how the proposed package of reforms can be practically implemented to deliver the change the Chancellor is hoping for. We look forward to working with Government and officials in the Department for Work and Pensions and His Majesty's Treasury to realise mutual ambitions for the pensions sector and the UK economy.

## Executive Summary

This call for evidence asks whether trustees (single employer and master trust) have the right knowledge and skills to consider investment in the full breadth of investment opportunities. The pensions landscape is increasingly complex, and the evidence on trustees' knowledge and understanding is mixed. Trustees of smaller schemes may not have the relevant skills and knowledge, and it is not clear that schemes below a certain size would have the opportunity to invest in anything other than public markets. On the other hand, many professional trustees, investment advisers, and master trust sponsors have extensive experience with a wider range of investments and are therefore potentially better equipped to invest in private assets, including within DB schemes.

The recent increase in pensions-related regulation and legislation, coupled with major events such as the LDI crisis, means the need for a higher level of knowledge and understanding on trustee boards has never been greater. It is increasingly difficult for lay trustees to make informed decisions efficiently and without over reliance on advisers. Pensions is not the day job for the vast majority of lay trustees and so it can often be challenging for them to keep on top of the demands on trustees.

IGG does not believe that an accreditation regime for lay trustees will necessarily deliver the economic growth and investment in productive assets that the Chancellor advocated in his Mansion House speech. This is because there is little evidence it will materially enhance knowledge and understanding on trustee boards. It will also likely act as a further deterrent to people coming forward to act as lay trustees. The broad range of skills, qualifications, and experience of lay trustees, together with their first-hand knowledge of the businesses that sponsor pension schemes, is a vast resource that has helped to underpin good governance. This can be enhanced significantly through the introduction of a professional trustee to each board. Additionally, the appointment of a professional trustee that is part of a broad, diverse team with the full range of skillsets required for highly effective trusteeship will ensure that inclusivity, representation and high quality can be achieved. In our response to this call for evidence, IGG is supportive of a move to mandate the appointment of a professional trustee for all schemes, over a workable timeframe, in order to enhance knowledge and understanding.

In principle, we consider that trustees having the opportunity to invest in unlisted markets is in members' interests in the long term, offering the potential for diversification, attractive net returns, and illiquidity premium. We see new companies in new industries raising capital from private rather than public markets. These new companies and sectors can be under-represented on listed markets, which are also becoming increasingly concentrated and reliant on the performance of a narrow range of industry sectors.

We therefore see it in members' long-term interests to consider private markets as part of the potential investment universe in which a default strategy might invest. This view is shared amongst leading investment advisers. The development of Long-Term Asset Funds as a potential pooled vehicle into which

DC schemes could invest is exciting and we would encourage regulators to support these funds. Recent changes to permitted links rules on life investment platforms by the FCA are also welcomed.

With respect to DC schemes, the advent of auto-enrolment has meant the provision of DC workplace pensions is changing from an inhouse workplace benefit to a financial service. The master trust authorisation five years ago supported this trend and was put in place to better protect members and to share the benefits of scale, backed by robust, sustainable pensions providers. Those sponsors and their professional trustees possess the capability and willingness to take sound long-term investment decisions in the interests of all members, in line with members' relevant retirement time horizons. For most DC schemes, it is unlikely to be in members' interests for their trustees to consider private market investments because they are too small. In schemes under, say, £1 billion, a worthwhile allocation to private markets is difficult to implement safely while still maintaining adequate diversification across the unlisted sector without access to robust pooled funds or fund-of-funds.

Even within larger schemes, which can be subject to closer regulatory scrutiny, trustees have genuine concerns about the very real implementation challenges and risks faced when considering unlisted investments within defined contribution pension schemes at this stage in the industry's development. The recent experience with property fund redemption freezes during the Covid-19 pandemic are still fresh in trustees' minds especially when, in some cases, the property fund freeze meant that members' entire pension pots (including the liquid parts) were not accessible when they requested and needed access. Failing to pay benefits as they fall due is clearly not in members' interests and is a breach of fiduciary duty.

As we see it, for DC schemes there are four material barriers beyond trustee knowledge and skills that Government must consider as part of the next steps following this call for evidence. They are:

- Cost of administering schemes,
- Liquidity management policies and prudential supervision,
- Scheme and employer longevity in single employer schemes, and
- Suitability of pooled funds, platform structures and inter-scheme transfer arrangements.

For DB schemes, as we see it, the barriers beyond trustee knowledge and skill that should be considered are:

- Due to improvements in DB funding positions, a large number of schemes and employers in a perfectly functioning bulk annuity market are at – or near the stage where – they would be ready to transact with an insurance company within timescales that are too short to make investment in productive finance suitable from a risk / return and liquidity perspective,
- There is potential for regret risk should the level of investment risk be increased through investment in productive finance assets and the strength of the sponsor covenant subsequently reduces to the extent that the sponsor is unable to make good any shortfall as a result of the productive finance assets underperforming, and

- Suitability of available assets in the UK.

Investing in productive finance, or indeed making any of the complex and multi-faceted decisions that trustees are continually challenged with requires objectivity, informed judgement and a comprehensive understanding of all of the financial and non-financial risks involved. We see the impact and value that the appointment of a professional trustee has for fellow trustees, sponsoring employers and, most importantly, scheme members daily. The knowledge, experience and expertise that a professional trustee brings ensures effective and efficient decision-making that benefits all stakeholders. For this reason, we recommend a gradual, although clear, move to mandating the appointment of a professional trustee to all schemes over a workable timeframe. Our experience is that this shift is already gaining momentum and it may be that the market arrives at this position before any regulation is introduced.

Mandating the appointment of a professional trustee – either as part of a wider board or as a Professional Corporate Sole Trustee – will enhance and add to the knowledge and understanding already present on schemes. It would also mean that potentially onerous mandated accreditations for lay trustees are not required, where, in our view, the likely outcome would be that the recruitment of lay trustees becomes even more difficult than it can be at present for many schemes. There are many obstacles that deter individuals from coming forward to act as trustees and anything that adds to that list will only serve to compound this position. We also believe that professional trustees can help many boards ensure DEI objectives are achieved and deliver the representation that is critical to effective decision-making.

For their part within DC schemes, trustees can take steps to generate higher long-term returns within default investment strategies while members are young – and that includes benefiting from the liquidity premium, diversification, and growth potential available in unlisted markets. To provide an adequate pot in retirement, the most effective strategy to follow is to increase contributions to beyond the current auto-enrolment minimum. To provide adequate liquidity and while sharing costs fairly and mitigating risks, DC schemes need to keep growing and achieve a sustainable size where investment in private markets is prudentially sound.

Practical policies from TPR to support the consolidation, growth and security of DC schemes are welcomed. This includes policies that continue to strengthen the quality and capability of the pension trustee profession.

For DB schemes, IGG would welcome an appropriate decision-making framework with clear and proportionate regulatory supervision for enabling the consideration by trustees and sponsors of a wider range of investment opportunities, whilst ensuring that the security of members' benefits is maintained.

## Knowledge, Understanding and Capability

*IGG's response to Questions 1 to 5*

Accredited, professional trustees have a strong understanding of their roles and responsibilities as well as the minimum standards they must meet. The knowledge and understanding of lay trustees will naturally vary depending on their experience and day-to-day work.

In general, schemes with professional trustees and/or larger, well-run schemes that have good support from professional advisers and which are well-resourced are well-acquainted with the expected standards and have a strong governance framework in place. Professional, accredited trustees are, rightly, held to a higher standard by law than lay trustees. There is much reliance placed upon investment and pensions advisers to provide support to trustees. In some instances, this reliance can mean that, where trustee knowledge and understanding is not optimal, a board is not well-positioned to challenge advice and can become adviser led.

TPR surveys have suggested that trustees of small schemes may not know and understand what is expected of them; indeed, TPR's announcements that many small schemes were not aware of the value for money requirements they should be complying with would support this. The appointment of professional accredited trustees on single employer scheme boards should be encouraged as a way of supporting and enhancing overall standards.

Professional corporate sole trusteeship is growing. This trend should be supported by regulators where appropriate, for example in organisations where it is becoming difficult to find trustees with the required skill set and capacity for the role, as it enables both smaller and larger schemes to meet the required standards. In short, support is available where the sponsor is prepared to fund the costs of high-quality governance.

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. Trustees who hold themselves to be expert in a particular area, such as investments, are held to a higher standard, whether they are professional and accredited or not. This can deter prospective lay trustees with investment experience from taking appointments.

When considering changes to the Trustee Toolkit, IGG recommends Government considers the effect of a minimum threshold of capability for lay trustees. IGG is concerned this would result in a reduction in the numbers of competent individuals who it is expected would be otherwise interested in fulfilling that trustee role. IGG would welcome the opportunity to work with Government in further developing alternative policy solutions to increase knowledge and understanding on trustee boards, for example, the mandating of a professional trustee on boards.

Investing in illiquid assets is different to investing in public assets. The measures of risk and return that trustees expect in public markets don't apply well to private markets, and portfolio construction, currency hedging, risk management, performance, manager evaluation and climate impact are all different.

Trustee boards have the option to appoint professionals to advisory roles or investment committees to supplement the board's expertise in areas such as illiquid investment and this should be encouraged.

Where a scheme either isn't supported with a professional trustee or high-quality advisers, the only real opportunity to improve trustee capability is for trustees to undertake regular training themselves.

For DC schemes, it is likely that the trustees of master trusts and of larger occupational schemes will lead in the area of investing in private markets given that opportunities to do so will likely be available initially to schemes of this size, and with the governance structures to support this.

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. As pension solutions become more complex it, in turn, becomes increasingly difficult for trustees (and indeed advisers and investment managers themselves) to fully understand and account for all the features and risks of certain investment decisions/strategies.

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. This can be inefficient and slow down decision-making, which can be detrimental where time is of the essence.

As a potential solution the use of specialist trustees could be more widely adopted. For example, trustees with investment experience/qualifications could support the wider trustee board or professional corporate sole trusteeship team to consider a broader range of investments. Moreover, a revision of the Trustee Toolkit to review and update the modules on investments and funding would be extremely helpful in improving knowledge and understanding.

For DC master trusts most trustees, their sponsoring firms and many employer scheme trustees have extensive investment experience, including in unlisted investment markets, or access to that expertise through their advisers. In the case of professional trustee firms which adopt an 'integrated service model', trustees also have access to a wider team of pensions professionals, including those with specialist investment expertise, from within the professional trustee firm. Trustees are also willing to consider these unlisted markets with the support and advice of investment consultants, where the case for such investments (higher net long term returns and improved diversification) is compelling as a result of the specific circumstances of the scheme.

However, it must be recognised that not all investment experts believe that investing such assets is in the long-term interests of DC scheme members who bear the extra risk (especially liquidity and valuation risk) and the costs (especially the initial investment costs). This is a matter of investment beliefs but would also depend on the profile of the scheme: if the scheme is closed or has a high proportion of older or deferred members, then holding long term assets is a mismatch with the timeframe in which they would expect to access benefits. There

is a difference between having the right knowledge and understanding to invest in the full breadth of investment opportunities and considering it in members' interests for a particular scheme to do so.

Below a certain size of scheme there is a view that the extra risks involved in unlisted assets cannot be justified or implemented safely. Most remaining DC occupational schemes fall into this category of insufficient size to consider unlisted market investment. It would be useful for TPR to state in its policy framework the minimum sustainable size of scheme that could and should consider including private markets, with an initial suggestion that this is at least £1bn. Risk warnings would need to be given to members to make clear that there may be periods of time where access to their benefits may be limited at times.

Many employer sponsors will be considering a move to master trust in the next 5-10 years and so their trustees would see investing in private markets as incompatible with a prospective scheme windup. Master trusts need to be encouraged to accept in specie transfers of unlisted assets and this can be an obstacle to stand alone DC schemes when negotiating terms with master trusts. TPR can play a role in encouraging master trusts to accept (and pooled funds to offer) in specie re-registration between schemes and master trusts, along with the development of secondary markets in unlisted assets between schemes.

Until the recent changes in the permitted links rules by the FCA and the development of the LTAF, such investment has not been possible to implement on the life insurance platforms that most large DC trusts and master trusts use.

The costs of acquiring unlisted assets are seen as a barrier by master trusts and stand-alone schemes. Until schemes grow larger, the industry needs pooled funds and fund-of-fund structures to facilitate cost-effective investment in and transfer of unlisted assets.

Employers selecting a master trust will generally prefer the lower cost on transferring their employees, even if the higher cost default option offers higher prospective member returns. These decisions are primarily focused on low costs. Hence there is little appetite at this stage in the consolidation stage of the DC market to include unlisted assets in default options by master trusts if this leads to an increase in member fees.

What would cause this to change? A market where schemes compete on expected long term net performance as the dominant factor in value for members. TPR can require or influence employers and their advisers to give prospective net long term investment performance the dominant weighting in their master trust selection decisions. This is considered in the separate value for money consultation but the weighting to expected net investment returns as the primary selection criterion is key.

**Consolidation**

Consolidation at a DC scheme level is well understood. There are still barriers to achieving this related to member protections, such as tax-free cash and DB underpins. Now that DB liabilities have shrunk and journey plans to buy-out possibly closer in time, this is an opportunity to eliminate or buy out such

protections in the interests of DC consolidation. Policies that assist trustees and sponsors to overcome member protection barriers are welcome.

In the DB space, consolidation through superfunds is a relatively new concept. Whilst the Pensions Regulator previously released its approach to consolidation through superfunds, Government has only recently published its response to the 2018 consolidation consultation on superfunds. Further, the industry is yet to see draft consolidation regulations, making it difficult for most trustees and sponsors to understand the legal and regulatory steps needed to engage with consolidation vehicles. However, it should be noted the recent easing of the guidelines to gateway principles may help to prompt some activity. In our experience many trustees and sponsors have sought to monitor the progress of the superfund regime with the help of their advisers, and some have actively considered superfunds as an option to improve security for members' benefits. To date, the delay in finalisation of the formal regime has been a barrier to the successful establishment of superfunds.

However, it must 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 may work to preclude the consolidation option for many schemes.

As master trusts (DB and DC) grow over time, pricing will be less of a barrier. Large, growing master trusts will receive strong contribution inflows to manage cashflows on illiquid investments. Regulators could be more demanding of master trusts of beyond say £5bn, to consider private market markets in their default offerings.

## Accreditation and Training

*IGG's response to Questions 6 to 10*

IGG is not inclined to support the TPR keeping a register of all trustees as it is unclear what the purpose of such a register would be and how this would lead to increased investment knowledge and capability amongst trustees. The professional trustee sector has made great strides in recent times with accreditation, as well as the recruitment and retention of skilled individuals with backgrounds in all the key disciplines and subject areas required by occupational pension schemes. IGG calls on the Government to work with TPR and industries bodies, such as APPT, to develop a professional register including those who had advanced skills and capability in particular areas such as investments, administration, and communications.

It is unclear what information would be collected or how it would be used or accessed. Regardless, the current return is more than able to be updated to collect 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 if requiring them to complete a second return.

It is up to each trustee board to ensure it has the required skills and capability in all areas of trusteeship, including investments, from across the trustee board, and

the wider team of pension professionals that support or advise the trustee board. We would encourage TPR to work with professional bodies to agree minimum standards in all areas of trusteeship, including investments. Master Trust boards also seek to identify the skills and backgrounds of their trustee boards to ensure they have a well-rounded governing body in all areas, including investments.

All IGG staff that lead trustee appointments are fully accredited professionals. Therefore, where we act as professional corporate sole trustee, the entire trustee board is accredited. Where we act in a co-trustee capacity, we are typically the only accredited trustee on the trustee board except in the case of DC master trusts which are largely made up of professional, accredited trustees and other trustee boards containing more than one professional trustee.

It is becoming increasingly difficult to find individuals who are prepared to act as a lay trustee. 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. It would seem to be a difficult ask without placing a greater onus on scheme sponsors to support one or more lay trustees with additional training, time, and financial resources.

IGG calls on the Government to mandate accreditation for all professional trustees so that those schemes appointing a professional can be sure of the observation of certain minimum standards. We believe that mandating the appointment of a professional trustee for schemes over a workable timeframe will raise the standards of trusteeship across the industry.

DC schemes, because of auto-enrolment and a phase out of DB schemes, will be the primary pension benefit in the future of UK retirement savings. The master trust authorisation regime offers members greater protection than the substantial number of remaining employer defined contribution schemes, which do not fall under the same standard of supervision, governance and capital reserves. We believe that all members deserve a minimum protection, in alignment with TPR's statutory objective. Therefore, we see no reason why, over time and with an appropriate degree of stakeholder consultation, trustee boards of single-employer schemes should be subject to lower standards than master trusts, in relation to trustee capability, supervision or capital reserves. This two-tier regulatory regime is not in the interests of those members outside master trusts.

We suggest TPR consider whether stand-alone single employer DC schemes over a certain size should be subject to an authorisation regime like that of master trusts, to create the same protection regime for all DC and auto-enrolment savers. DC sections of hybrid schemes under a certain size might be excluded from this requirement.

## Requirements and Standards for Professional Trustees

*IGG's response to Questions 11 and 12*

IGG defines professional trustees are those in the business of accepting trustee appointments as a paid professional service. IGG is a firm of professional trustees.

We support mandatory accreditation for all trustees acting in a professional capacity. We welcome the opportunity to enter into dialogue with Government, alongside APPT as our professional body, and the industry more widely on the potential evolution of requirements for those acting as professional trustees and, as one of the leading professional trustee firms in the UK, are well-equipped to do so.

## External Advice and Support

*IGG's response to Questions 13 to 17*

Many investment advisers to pension trustees and their sponsors undertake consideration of investment in unlisted investments where in the interests of members and believe that an allocation to private markets can enhance net returns. However, costs and implementation barriers (especially liquidity and size) outlined above deter trustees from proceeding.

Advisers will analyse the characteristics of any specific investment option, such as risk, return and costs, in the context of TPR's investment, funding and other guidance and then position the options in the context of the scheme's longer-term goals. It should be noted that this is likely to result in investment decisions that have a lower risk profile, which in turn will result in lower returns. This will impact the realisation of the Chancellor's ambitions as investment in productive assets will not be the status quo, particularly for DB schemes with more mature membership profiles.

The sponsors of many smaller DC scheme sponsors may be unwilling to cover the costs of quality advice that might lead to such recommendations, particularly where it is not clear that such options would be available to schemes of that size.

Liquidity risk to the scheme is increased when trustees invest in unlisted equities and at present there is little policy or guidance available from TPR for liquidity management, scheme stress testing and valuation policy within a DC context, along with suitable risk warnings to members. These elements can firstly be addressed within the supervisory regime of master trusts, and subsequently introduced to single employer schemes.

For DC schemes there is no employer standing behind master trusts, no PPF regime and the capital reserves are put in place for the purpose of covering wind up costs, not for liquidity. Since members bear the investment risk in DC, including liquidity, any increase in illiquidity must be managed and policies set out by TPR as supervisor to do so. Diversification remains the trustee's mitigant for investment risk across all investments within the default strategy and continues to be in members' long term financial interests. A such, unlisted investments are only suitable and safe for schemes of a minimum size, sustainability and capability.

Regulators may look to boost or mandate investment in UK private markets by expanding trustees' fiduciary duty to consider the non-financial long-term interests of members as relevant factors. However, evidence would be required

that those factors were relevant to members' interests within the context of the purpose of a pension scheme.

Where trustees support the benefits of unlisted assets for scheme members, we have not seen push-back from investment consultants in principle. With respect to DC schemes, investment advisers are unlikely to recommend allocations to unlisted markets for smaller schemes due to cost, liquidity and diversification constraints already mentioned.

Changes include the availability of suitable pooled funds on life insurance platforms and effective transfer of unitised pooled assets upon transfer between pension schemes, with explicit notice periods.

Legal advisers provide advice 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.

The legal advisers that IGG work with are not reluctant to see trustees invest in illiquid assets provided their due diligence on the investments and the strategic investment advice is sound. This means considering all relevant factors and disregarding irrelevant factors, on a whole-of-scheme basis, based on the sound investment principles and risk management strategies including diversification and liquidity management.

On the DB side, it 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.

## Fiduciary duties and obligations

*IGG's response to Questions 18 to 25*

Pension trustees invest in members' interests and follow the Myner principles which include taking professional advice and ensuring investments are adequately diversified, and that liquidity is available so that members' benefits can be paid when due. One of the key principles of sound investment strategy in the context of a DC scheme is setting and aligning beneficiaries' investment risk to their investment time horizon.

Determining the investment time horizon of each member's pot within the scheme, even in large schemes such as master trusts, is not the same as knowing the investment time horizon of each individual saver. This is because:

- Older members require liquidity to access their savings from aged 55,
- Deferred members are increasingly likely to transfer to a consolidate their pots due to multiple employers over their lifetime

- Employers can move to new pension providers with short notice, and
- The master trust sector is in the process of consolidation.

All these potential changes require large schemes, including master trusts, to assess their required liquidity and set investment strategies with those projected liquidity events in mind.

Trustees set investment strategies according to the period they expect to remain in the scheme which may be different to members' retirement age or access age. Members may require liquidity for a host of reasons including access to benefits on retirement or earlier than planned, transfer to consolidate pots, and bulk transfers of employers to other schemes.

To align investment risk to liquidity, it would be useful if TPR provided guidelines for schemes as part of its prudential supervision (including DC master trusts). This would include liquidity management plans with scenario forecasting, scheme stress tests for liquidity and valuation guidance for non-listed assets, as well as a review of the 'deemed default' guidance set after the property freeze during covid. These are standard parts of prudential supervision that trustees could follow with confidence as a basis for managing scheme liquidity.

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

Trustees are legal asset owners, investing on behalf of the scheme beneficiaries, meaning 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. Fiduciary duties mean that investment in alternative asset classes can be inappropriate based on member profile, needs and time horizon.

The trustees' need for providing daily pricing in DC schemes can work against the inclusion of illiquid asset classes where those investments provide less frequent valuations and redemptions. This can only be adequately managed in large schemes.

More than half of many DC schemes member pots and assets are deferred due to the proliferation of pot numbers as members change employers. Pensions Dashboard and the small pot aggregation proposals are a potential call on scheme assets to consolidate member pots to achieve fewer accounts per member. At the member level, this is a good thing to provide control over missing retirement savings, allowing for more efficient saving and better planning. However, for DC schemes, it could mean providing liquidity to thousands of members' pots suddenly if they transfer to an external aggregator vehicle. This sudden rush of redemptions can mean that prudent allocations to unlisted assets breach their limits and take time to correct using inflows as available.

It could also mean being forced to put limits on redemptions and/or selling unlisted assets at a discount, none of which is in members' interests. Prices in the DC master trust market at a member level will need to increase to accommodate unlisted investments and trustees are generally willing to facilitate this based on improved value for money.

Improved value for money means higher net long term investment returns for those members in accumulation with a suitable investment time horizon. To move the dial on value for money, meaning more weighting on project net investment returns and less weighting on costs in the employer's decision-making, TPR must be more prescriptive.

Training and guidance may take many years and meanwhile, members miss out on returns and reach retirement without adequate savings. It is difficult to generalise, but professional trustees do have more time to perform their duties and hone their skills by virtue of the number of schemes they are involved with. In particular, the time required as a professional trustee serving on the board of an authorised master trust is far more than that on a single employer board and reflects the level of prudential supervision by TPR.

Within the trust-based DC pensions market, the past decade has seen substantial consolidation, with many employers and trustees winding up their single employer schemes and transferring to master trusts. As a result of this consolidation, master trusts have grown to be multi-billion-pound schemes, but they are still relatively small in global terms. As expected, the focus of master trusts' investment governance is the design and outcomes of the default strategy, where 90%+ of members' retirement savings are invested. However, to date, neither large, single employer nor master trusts (even with their substantial size and trustee capability) have invested to any significant degree in unlisted asset classes, such as property, infrastructure, private equity, including venture capital and private debt.

Employers (rather than trustees) select master trusts based on costs, rather than expected long term net performance, which in turn constrains master trust providers from offering more expensive default strategies containing unlisted investments. While it is trustees' responsibility to set investment strategy, master trust investment propositions are generally driven by providers. Providers' proposals are set within the commercial context of market conditions, including a design and price that they believe their target employer market and their advisers will bear. Given a choice between a low-cost default investing in largely liquid, indexed investments and a higher cost, more diversified default containing private markets, employers today are much more likely to choose the former.

High initial and ongoing fees, including performance fees, make total member costs uncompetitive in a market since value for money has focused largely on costs rather than net long term returns to members, and driven pricing down. Trustees and providers who include such investments in their default strategy in members' long term financial interests will need the confidence to justify increased fees to members. For example, consider a scheme whose trustees set an allocation of 30% in illiquid assets within their default strategy, including a 5%

allocation to private equity (being the most expensive and highest risk asset) alongside property, infrastructure and private debit. That would push up costs by circa 40 to 50 basis points; at that price, schemes would not sell in the current market. TPR, employers and the market will need to accept that the average default strategy fees of trust-based workplace pensions could rise substantially from current levels and still be considered value for members.

There remains uncertainty in government policy on consolidation at the member and scheme level. 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.

**Liquidity management policies and prudential supervision**

Liquidity risk to the whole of a DC scheme is increased when trustees invest in illiquid assets. IGG recommend more detailed policy and guidance be published by TPR for liquidity management, scheme stress testing and valuation policy within a DC context. These elements can be addressed within the supervisory regime of master trusts, and then expanded to single employer schemes.

In addition to asset liquidity, the liquidity profile of the member base must be considered. Most open DC schemes contain more than 50% of member pots and assets with deferred benefits. These pots are subject to transfer at any time as members are urged to consolidate their pensions savings into one vehicle (especially once Pensions Dashboard and the small pots solutions are introduced). Therefore, a good level of liquidity is required even for large schemes and master trusts to support the deferred section of their member/asset base. There is uncertainty around how any changes to the Government's policy on the issues of small/deferred/multiple pots will impact demands on DC scheme liquidity as and when implemented.

**Scheme and employer longevity – single employer DC schemes**

Even in larger single-employer schemes, trustees and their sponsors need to be sure that the expected life of the scheme matches the investment horizon of its members. The relevant considerations are:

- Whether the scheme still exist in the 10+ year life of the proposed unlisted investments,
- What is the chance that the scheme will move to a master trust, and if so, what would be the willingness of master trust to accept those assets on transfer, and
- Whether trustees of larger single employer trusts assess the sponsoring employer's covenant and require reserves in case of wind-up, as is the case with master trusts.

There is a sound argument that members in both single employer and multi-employer DC schemes deserve the same protections under TPR's statutory objectives. IGG has experience in the discontinuance of stand-alone DC schemes

under insolvent employer sponsors with no reserves, with detrimental member outcomes. It is not in members' interests to see mismatched time horizons – especially if the scheme is closed to contributions, likely to wind up and move to master trust in the next few years, has a large older or deferred population.

**Suitable pooled funds, platform structures and inter-scheme transfer arrangements**

The investment platforms used by many DC schemes have gating rules which can limit cash flows in certain circumstances. The use of such platforms and/or their terms and conditions could be reviewed or renegotiated or consider the use of discrete mandates. Some life insurance platforms cannot accommodate unlisted assets, although this has improved through 2020 FCA reforms to permitted links rules. Lack of co-investment opportunities which might allow schemes to share risk and costs if assets could be pooled. Some pooled structures need to permit re-registration of assets by new trustee owners on transfer.

Employers may move their active members between master trusts with reasonable notice under many participation agreements and the ceding master trustees are inclined to agree to a transfer of active members' existing pots to another authorised master trust. It is generally in the interests of transferring active members to keep their future and past contributions together, avoiding further proliferation of pot numbers. If the ceding scheme's default holds a material level of illiquid assets, transfers between master trusts could prove problematic, without the requirement of the receiving scheme to accept in specie transfer of assets. Any policies developed by TPR on illiquid investments within the master trust sector must therefore consider issues such as employer notice periods, in specie asset transfers and practices regarding purely deferred member pots and schemes.

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As the Government finalises its response to this call for evidence, we would welcome the opportunity to discuss our response in detail with officials.

Please contact Mark Wileman, Chief Business Development Officer, in the first instance (mark.wileman@weareigg.com; +44 (0)7774 803653).