CFA Society United Kingdom

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FAO: Rt Hon. Laura Trott MP & Rt Hon Andrew Griffith MP,

CFA UK's Response to the DWP and HMT's joint call for evidence on pension trustee skills, capability, and culture

The CFA Society of the UK ('CFA UK')[1] welcomes the opportunity to comment on the government's call for evidence on pension trustee skills, capability and culture. Improving the skills and capabilities of our members is core to our mission. Our Society's purpose is to grow talent and educate investment professionals and so improve the service they provide to their clients. Many of our members work in the UK pensions industry, either directly as managers, trustees or consultants or in companies providing investment services to UK pension funds.

The Call for Evidence interrogates three areas: (i) trustee skills and abilities; (ii) trustee advice and (iii) barriers to trustee effectiveness. As our Society's focus is on investment, rather than pensions, we have chosen to focus just on the first two sections of the paper. Whilst we also have views on the third area we have chosen to limit our responses to the first 17 questions of the Call of Evidence and are annexed to this letter in Appendix II.

We believe it would be helpful to make the following key observations which recur throughout the responses to the questions set:

The primacy of ongoing individual trustee professional development

Together with our umbrella organisation, CFA Institute, we champion the importance of investment professionals improving their competency on a continuing basis. CFA Institute's Code of Ethics[2] requires CFA charterholders and exam candidates to amongst other things: "*Maintain and improve their professional competence and strive to maintain and improve the competence of the investment professional*".

- For this reason, we believe that the DWP and TPR are right to focus not just on the appropriate degree of rigour for the entry accreditation for trustees, but also (i) the support given to allow trustees to develop their skills once in post and (ii) evidence of each individual trustee's commitment to their own continuous personal development. We agree with the suggestion that the TPR start a central register of

[1] CFA UK is a professional body representing over 11,000 investment professionals in the UK. Appendix I contains a summary of the mission, purpose and activities both of CFA UK and that of our umbrella organisation, CFA Institute.

[2] CFA Institute's Code of Ethics and Standards of Practice: https://www.cfainstitute.org/en/ethics-standards/ethics/code-of-ethics-standards-of-conduct-guidance

trustees, which should record each trustee's development accreditation and the development thereof to underline the importance of this. The Chair of each trustee board should have an important role to fulfil in ensuring individual trustees work at this appropriate to their individual situation. For each individual trustee to become the best version of themselves calls for both targeted training and learning on the job.

The effectiveness of both the individual trustee and each trustee board
We believe that the role of a pensions trustee is a demanding one and we agree with the reasons cited in the Call for Evidence as to why it will likely become yet more demanding. Individual pensions trustees require a broad range of skills and it is probably impossible for any single trustee to be an expert on all trustee matters. Fortunately, each pensions trustee, unless they are a sole trustee, serves as part of a trustee board which receives professional advice, and, assuming that board functions well, each individual trustee can be allowed to develop specialist skills in certain areas. Thereby 'the team' works together to cover all angles, just like on any corporate or management board, and diversity of thought is a critical component of any well-functioning board or team. A corporate sole trustee also delivers this through the diversity its trustee directors and it is important that they work together as a board in the same way.

- For this reason, any proper assessment and control regime of the skills and abilities of pension trustee boards needs to take place at both an individual and collective board level. A well-functioning board of trustees will have diversity of thought, which means its members may not all come from professionals in the pension industry. It should also act as a "learning haven", particularly for new trustees allowing them to acquire the necessary skills and capabilities quickly over the first 1-2 years of their trusteeship. Focusing purely on the investment skills requirement we believe that every trustee board should have at least one member around its table that has an OFQUAL level 6 financial qualification as a minimum, or the equivalent experience and skills in investment equivalent gained through professional work over many years.

Our vision of how a trustee accreditation regime might work
Investment knowledge and expertise is by no means the sole requirement of trustees, but it clearly is of great importance, and the shift from DB to DC and the anticipated growth in allocations to illiquid assets brings new challenges. Through our lens purely of investment, we believe that the bar set by both the trustee tool-kit and the entry level exam for professional trustees to be relatively low. To be effective, a board of trustees needs to have at least one (as a minimum) and ideally several (to provide challenge and debate) members with genuine financial and investment expertise acquired through more demanding qualifications or professional investment work.

For this reason, we consider that the TPR could expand on the entry level exam and the trustee tool-kit to build an accreditation regime which could be shared by both lay and professional trustees, with the bar set higher for professional trustees i.e. a level I and a level II. Each level could have a core curriculum overseen and managed by the TPR with supplementary modules on specialist subjects built onto it. These modules could be provided by third parties such as universities or professional organisations and might include modules on alternative assets or unlisted equities, for example. Having such a layered and modular curriculum regime would encourage and facilitate trustees to take active ownership of their professional development. It would also be clearer what specialisms a board was lacking under such a regime. By selecting and crediting appropriate third-party qualifications the TPR could accelerate the acquisition of skills by trustees in new areas such as unlisted equities, climate investing, alternative assets etc. Having a comprehensive and dynamic trustee education curriculum in place would also make it easier for trustee boards to hire new trustees from a wider pool of candidates, placing greater weight on talent and potential rather than simply relying on years of buy-side investment experience. This will widen the diversity, equity and inclusion on trustee boards and should over time lead to better decision-making.

In line with our Society's purpose, we aim to highlight relevant issues to help the investment community to serve its stakeholders well and to build a more sustainable future.

We are grateful for the input into this letter of our Pensions Expert Panel which is made up of senior pensions consultants, investors and asset management service providers as well as a professional pensions trustee and a representative from CFA Institute.

Yours sincerely,

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CFA Society of the UK

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With thanks for the oversight of the [Professionalism Steering Committee]

APPENDIX I: About CFA UK and CFA Institute

CFA UK serves over eleven thousand leading members of the UK investment profession. Many of our members work either managing investment portfolios, analysing and advising on investments, or in some form of investment operations and oversight role.

The mission of CFA UK is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence in order to serve society's best interests.

Founded in 1955, CFA UK is one of the largest member societies of CFA Institute and provides continuing education, advocacy, information, networking and career support on behalf of its members.

CFA UK has pioneered the development of ESG-related examinations for investment professional in recent years, specifically the Certificate of ESG Investing (now run by CFA Institute), the Certificate of Climate Investing and the Certificate of Impact Investing (currently under development).

Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

For more information, visit www.cfauk.org or follow us on Twitter @cfauk and on LinkedIn.com/company/cfa-uk/.

CFA Institute is the global association for investment professionals that sets the standard for professional excellence and credentials.

The organisation is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow.

It awards the Chartered Financial Analyst® (CFA) and Certificate in Investment Performance Measurement® (CIPM) designations worldwide, publishes research, conducts professional development programs, and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.

CFA Institute has members in 162 markets, of which more than 170,000 hold the Chartered Financial Analyst® (CFA) designation. CFA Institute has nine offices worldwide and there are 158 local member societies.

For more information, visit www.cfainstitute.org.

APPENDIX II: CFA UK RESPONSES TO QUESTIONS

I. TRUSTEE SKILLS AND CAPABILITIES

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

A well advised trustee board will know the standard expected of them.

As the Call for Evidence states: "It is worrying that the number of trustees engaging with the guidance is worryingly low. And *over a third of DC trustees had never read or were not aware of TPRs codes of practice."*

However, these results might be misleading. Typically, advisers will read codes and communicate content to their boards in an assessable format meaning that Trustees may well be broadly familiar with the content of specific guidance without actually recognising that they are, as it has not been presented to them and acquired by them as 'the guidance'. Perhaps advisors could be encouraged to refer to relevant guidance when they provide their advice so that this connection is made.

Guidance is, however, no substitute for lived experience and this is the key area where our members find that professional trustees add value, bringing experience earned serving on one trustee board to another.

Additionally Chairs of trustees are more likely to be conversant with TKU than other lay members of a trustee board and are likely to be integral in arranging an appropriate program of training. Most schemes require completion of the trustee toolkit within 6 months (and will provide training on scheme specifics to new trustees as part induction).

Specifically on investment, however, we believe that a board of trustees should have at least one board member with professional investment experience and an investment qualification around the table. We would describe this as someone who has an OFQUAL level 6 financial qualification as a minimum, or the equivalent experience and skills in investment equivalent gained through professional work over many years. This would equip the board to challenge their advisers (e.g. on why a full range of investment opportunities are not being discussed).

We note the findings of the TPR sponsored research suggests the majority, though not all, of DB trustees and large DC scheme trustees do have the knowledge and understanding expected of them; the problem area highlighted in the TPR research appears to be with small DC scheme trustees.

Question 2: Do trustees currently meet the knowledge and understanding requirements expected of them?

Collectively most boards will have the knowledge and understanding expected of them but on many boards not every trustee has it individually.

We note again the findings of the TPR sponsored research suggests the majority, though not all, of DB trustees and large DC scheme trustees do have the knowledge and understanding expected of them; the problem area highlighted in the TPR research appears to be with small DC scheme trustees.

Are some types of trustee better than others?

Even professional trustees will not have detailed knowledge of all aspects of running a pension fund and a push to up pension expertise in every trustee is likely to come at a cost of skills diversity and all manner of potential cognitive diversity (examples of usual additions to trustee boards who may not have much pension experience include the strategic thinking 'NED' or the gen Z and their understanding of digital engagement).

We would observe that there are some bad professional trustees and many good member nominated trustees (MND). On balance, of course, individual professional trustees will have more pension expertise. However, a board predominantly made up of professional trustees might introduce other problems. They:

- are part of the industry so a party to, and not a challenge to, 'groupthink'
- have the potential to intimidate other board members, and their presumed knowledge may stymie good logical challenge from others around table and limit diversity of thought.

Corporate Sole Trustee (CST) is an example of a trustee board that is in effect only investment professionals (i.e. the directors of the appointed trustee company) – we have seen no evidence that the investment strategies of CST schemes look markedly different from those overseen by 'traditional' boards, so we believe it might be hard to make the case that professionalising boards will result in a materially higher allocation to sophisticated investments.

However, CST has commercial pressures – it is often a fixed fee service with competition suppressing those fixed fees, which could act as an incentive to the provider of CST services to keep things simple. CST may bring less diversity to trustee decision making (there are no MNDs from a range of industries, for example).

Even professional trustees won't have detailed knowledge of all aspects of a pension fund and a push to up pension expertise in every trustee is likely to come at cost of diversity.

Question 3: What are the barriers to improving trustee capability?

Lack of time can be a barrier to the lay trustee improving their trustee capability. This might frequently occur when an employee joins the trustee board of a company's pension scheme but their line manager is not supportive of their 'additional' duties. Requiring employers to allow employees an appropriate number of hours to commit to their trustee responsibilities, with an offsetting reduction in other commitments, as a formal part of their role could be an approach to fix this.

We also believe that a barrier impacting trustee board effectiveness is the limited cognitive diversity on trustee boards currently, which could and should be improved; the aim would be to minimise groupthink, ultimately leading to better scheme outcomes. The IFOA's report[3] on pension trustee decision making shares that "women only make up 18% of all pension trustees and ethnic minorities just 3%. Around 60% of trustees are over the age of 50, whilst only 12% are less than 40 years old".

[3] Actuarial Research Centre, Institute and Faculty of Actuaries (IFOA): Pension Trustee Decision Making (2021) p36: https://www.actuaries.org.uk/system/files/field/document/Pension%20Trustee%20Decision%20Making_Research%20Report_0.pdf

What do you think government should do to ensure that all trustees meet the standards expected of them?

We think that the TPR should be tasked to develop a far more far-reaching curriculum for trustees than the current tool-kit and accreditation exams which we would describe as entry-level, baseline minima. They provide only a limited framework for trustees to pursue personal development in relation to their trusteeship.

We suggest that this curriculum should include core materials at two distinct levels for lay and professional trustees respectively with additional modules tacked on for important niche areas (like unlisted equities or alternative assets) that could be provided by third party universities and professional bodies but approved by the TPR. Please see our response to question 11.

With regards to improving cognitive diversity on trustee boards, while we note positive actions taken by the UK Government and regulators to improve diversity, equity and inclusion (DEI) within the financial services industry and society at large, for example the Equality Act (2010), the Women in Finance Charter (2016), Gender Pay Gap reporting (2023) and the TPRs Equality, Diversity and Inclusion (EDI) guidance for pension scheme governing bodies and employers (2023) among others, we believe that greater policy steps and further actions could urgently be taken by UK pensions regulators to catalyse a material improvement in the cognitive diversity within pension trustee boards.

Does trustee liability put off potential trustees?

Lay trustees are insured or exonerated against most risks, and we do not believe that trustee liability is a significant block.

Question 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?

The Call for Evidence states: *"In addition, there is evidence to suggest that improving trustee capability and skills, particularly in DC schemes, would improve trustees' ability to consider investment in a full range of assets, including unlisted equities, ensuring that they are able to seek the highest possible returns for savers".* We wonder whether this comment applies to most DC schemes or just the smaller ones?

It is worth noting that many Hybrid DB/DC schemes have a trustee board that is confidently investing in esoteric asset classes in the DB scheme but not doing so for the DC scheme. This suggests it is not knowledge and understanding that prevents investment in the full breadth of investment opportunities but some other reason. Possible reasons include:

- Fear of failure producing herding behaviour – others DC schemes don't do it
- Wanting to keep investments 'simple' for member understanding
- Inertia
- Relative costs and charges of unlisted equities, the existing value for money framework and the charge cap
- Time and resource spent on DC versus DB

We note that the consultation states: "*This will also support the growth of the UK economy, which ultimately benefits everyone".* We feel it appropriate to flag that many, if not most, trustees would rightly consider supporting UK economic growth to be outside of their remit to consider, given a narrow legal interpretation of their fiduciary duty. Trustees prime focus should be on the financial returns that can be generated inside a scheme not externalities, good or bad, outside the scheme.

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

The nature of the industry may limit consolidation of schemes, but this is probably caused by poor trustee understanding of advice so much as the advice they receive itself. One has to ask, what is the incentive of an adviser to suggest consolidation?

Depending on the project fees that an advisor might earn in the meantime, advice to consolidate:

- Leads to the loss of a potentially long term client in short term
- Might also indicate that the adviser has not succeeded in helping the trustee to elicit value

One proposal to consider might be to require independent consolidation advice. However, this might be commercially conflicted in the other direction (i.e. encourage a well-managed scheme offering value for money to consolidate if the adviser thought they might get the consolidation vehicle selection work).

There may be valid reasons why trustees and scheme sponsors should be concerned about consolidation – the loss of control comes with fears that a commercial third party will not care as much as employees or former employees of the connected sponsor.

While we note it is under consultation, we opine that the VFM framework has historically pushed too much towards an assessment of known costs rather than expected future risk adjusted net value.

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

Yes. This will assist in building a culture of accountability and of trustees taking greater ownership of their professional development.

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

The Scheme return is a well-established mechanism for feeding back key scheme data, so it would seem a logical way to achieve the trustee register. However, the more granular the detail sought, the more it might make sense to develop a separate web portal through which each trustee could update their own information.

Question 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?

We regard current standards as no more than an entry level qualification and a potential trustee could pass the examinations for accreditation without having the skills and knowledge to make a good trustee. As an entry level qualification, current accreditation frameworks do not act as a barrier to diversity of backgrounds (which a higher bar might) but nor would they be enough, without other skills and experience around the table to equip a board to properly fulfil role and make investment decisions. While not every co-trustee needs that higher bar of pension and investment knowledge, we would welcome every trustee board having at least one, and preferably two, suitably accredited investment professional serving as a trustee.

We do not believe it would be practical currently to introduce a higher bar requirement for all trustees – there would not be the availability of candidates and trying to do so would limit diversity.

The governance operating model also influences how much investment expertise the trustee board needs – for example, schemes using a fiduciary fund manager with a good oversight investment consultant also appointed, have less need to appoint an investment professional on the trustee board too, though they might bring additional welcome challenge.

Question 9: What proportion of your trustee board are accredited trustees?

We are not a trust board. However, our perception is that many lay trustees are not accredited.

Question 10: If we required each scheme to have a certain proportion of accredited trustees, where should this bar be set?

It is hard to answer this question without first knowing how high the bar might be set to achieve accreditation in future. Additionally, some trustees may be very highly skilled in particular areas e.g. be a CFA Charterholder and knowledgeable across a wide range of investments, yet not be accredited.

As a starter, we would suggest a good target might be for one third of most trustee boards to be accredited and for at least 80% of Master Trust boards to be accredited. This hurdle could be raised over time as accreditation became more prevalent. Another approach might be to require trustees to become accredited within the first, say, 2 years of their trusteeship. Trustees with suitable qualifications might be allowed to be passported through certain sections of the exam – for example, a CFA might not have to sit the investment section.

Should Master Trusts be required to have a greater proportion of accredited trustees than single-employer schemes?

Not mandatorily, but we would expect to see proportions as set out above.

Question 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?

We agree that there should be more rigorous requirements for those acting as a professional trustee when compared to a lay trustee and that accreditation should be mandatory for professional trustees. In particular a sole trader professional trustee should meet a high bar, but trustee firms themselves need diversity of thought, skills and background (e.g. when acting as a CST) and with proper peer support and development, these firms provide the ideal pipeline for the development of a younger future generation of trustees.

Lay trustees could be required to become accredited within (say) a period of two years of their trusteeship. A grandfathering regime could apply for existing trustees which are already deemed to have sufficient knowledge and understanding from experience.

The accreditation regime could be shared by both lay and professional trustees with the bar set higher for professional trustees i.e. a level I and a level II. Each level could have supplementary modules on specialist subjects to build onto a core curriculum which could be provided by third parties such as universities or professional organisations.

There would be at least two key benefits to having a comprehensive and dynamic trustee education curriculum in place:

- First it would provide each Chair of Trustees with a valuable tool to help them develop each individual trustee in a way that was appropriate both for them individually and for the board as a whole. We strongly believe that for each individual trustee to become the best version of themselves calls for both targeted training and learning on the job.

- Second, it would also make it easier for trustee boards to hire new trustees from a wider pool of candidates, able to place greater weight on raw talent, personal commitment and potential rather than simply relying on years of previous buy-side investment experience. Hiring in this way from a wider pool will widen the diversity, equity and inclusion on trustee boards and should over time lead to better decision-making.

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

A professional trustee should be able to demonstrate independence and be remunerated for their role (an investment professional volunteering their time to the trustee board of a not-for-profit board should not be considered a professional trustee). A professional trustee would normally also provide services to at least one other unrelated entity, although we note there are some very effective professional trustees whose only work comes from related sources. They could be paid for by the scheme or, with appropriate guardrails, the scheme sponsor.

There might be a good case for an individual acting as a paid trustee for just one unrelated entity to not be considered a professional trustee if they are not a pension professional. This would help trustee boards to recruit diverse skills without the need for accreditation being off-putting.

II. THE ROLE OF ADVICE

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

If they are to invest in unlisted equities, most pension schemes will not do this directly but via a fund-of-funds approach. This simplifies the challenge considerably though appreciation of the illiquidity considerations, range of cost structures, different market information sources and benchmarks, typical minimum investment sizes, infrequency and unreliability of valuations and dynamics of different relationship structures possible with PE firms will be foreign to trustees used to investing purely in public markets. Trustee reliance on consultants is likely to be heavy, especially in the initial years.

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

Trustees will usually rely on one investment consulting firm for all investment advice and not all investment consulting firms will research all asset classes. Private equity ("PE") vehicles are likely a case in point because defined benefit schemes have been letting their PE investments run off whilst defined contribution schemes generally have not been investing in PE. It has therefore become uncommercial for investment consulting firms to research this sector, as they need to find a way to be remunerated for their research efforts.

Some consulting firms are subject to conflicts of interest. This was identified by the CMA review. However, the resulting legislation does not address all aspects of potential conflicts e.g. investment consultants may develop their own Master Trust propositions and the act of recommending those own arrangements is not covered by competitive tender requirements.

We believe that field consultants that attend trustee meetings can vary in quality, even when a firm has good 'house' ideas. Furthermore, 'house' ideas may be a list of revenue generation opportunities for the investment consulting firm in question, meaning trustees can be suspicious that they are getting a sales pitch rather than suitable advice. Scheme budgeting pressure might also result in genuinely 'good' ideas not reaching the board.

To improve advice, we believe it may be worth encouraging trustees to consider specialist consultancies for different areas of investment advice e.g. for PE advice.

We note that for small schemes, minimum investment requirements of PE providers coupled with scheme liquidity constraints may simply mean that unlisted equities are not a viable proposition.

If it has not been done recently or is in train, unlisted equities could be added as a topic to the TPR's trustee tool-kit.

Question 15: To trustees: To what extent do trustees use investment consultants to support decisions around allocations to unlisted equities?

The regulatory environment is such that trustees are completely reliant on investment advice – they need to take suitable advice to amend their SIP and select investments. Going 'against' investment advice is difficult for a trustee to do – effective decision making might arise when a board has a discussion on pros and cons of any investment with its consultant with good debate and challenge, with the consultant issuing advice that takes on board the trustee views.

Trustees will typically be 'trained' on an area of investment by their consultant, who then gives them the investment advice – this model is not particularly conducive to constructive challenge as the trustee is not hearing any differing viewpoints. Trustees should arguably seek more training from third parties with alternative views before making decisions especially for new asset classes like unlisted equities.

Did they subsequently increase?

We have no experience of this which we can report.

Is there a deficiency of knowledge or expertise by investment consultants of these types of investments?

We observe that many investment consultants are now CFA charterholders and elect to tackle the CFA program rather than actuarial exams. The CFA syllabus contains specific content in relation to private equity in each of the three papers in the curriculum and is worth roughly 8% of the total marks available.

The CFA program curriculum looks at inter alia the different PE fund fee structures and legal clauses, illiquity premia, valuation challenges, benchmark choices, calculation of pre- and post-money valuations, transparency and disclosure issues, (lack of) control discounts and compares the Yale and Canadian endowment models for pension fund asset allocation with schemes investing only in publicly listed assets.

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

A more collaborative relationship with investment managers might bring in more independent viewpoints. This can be difficult to achieve, however, as consultants are often the gatekeeper to the investment manager and do not necessarily encourage the investment manager to develop a direct relationship.

It is also possible that the risk of being perceived as a fiduciary, may prevent some investment managers giving valuable input.

Question 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'?

We are not responding as a trustee, however we observe that legal advice probably has limited impact on investment decisions although reminders of fiduciary responsible may make some trustees nervous of pursuing ESG.

Tolerance for investment risk is considered at fund level with any components' risk only part of considering whether to add an asset class. Trustees also need to consider how it diversifies risk and adds to return at a portfolio level. A culture of risk aversion is probably less about investment risk and more about regret risk (fear of getting it wrong) or risk of being outlier (producing a herding mentality).