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Diversity, equality and inclusion (DEI) in pension scheme boards

DEI is important from a covenant perspective, both in terms of identifying long-term sponsor risks, and for good trustee decision-making relating to the security of members' benefits.

Cardano, in partnership with Mallowstreet, recently commissioned research in response to The Pensions Regulator's (TPR) calls for the industry to improve DEI. The aim of this research was to gather data to assess the level of awareness of DEI issues among trustees, raise awareness of the importance of DEI in the pensions industry and identify areas of improvement that can be made.

This research identified four key findings:

1. Pension trustee boards remain overwhelmingly white, male, over the age of 45, and with a tertiary education. More specifically:
   - 75% of respondents sit on boards where over 60% of members are male;
   - 2 in 5 sit on boards where half the board are 46-60 years old;
   - 70% say that four out of every five board members have tertiary education (e.g. university); and
   - People from ethnic minorities, people with disabilities, LGBTQ+ people and non-binary people represented less than 20% of trustee boards for over 90% of respondents

2. In contrast to traditional pension scheme boards, the research found that Professional Trustee (PT) firms appear to be generally more diverse, particularly in terms of age and gender. One in five PT firms surveyed reports that over 40% of board members are below the age of 45, and over a third of PT firms surveyed reports that more than 40% of their trustees are female.

   Over half (57%) of PT firms have a DEI strategy in place or plan to implement one within the next 12 months, relative to only 32% of schemes without PTs.

3. Whilst most trustees (63% of those surveyed) recognise the benefits of good DEI, progress has been slow. The lack of DEI in the industry is mainly attributed to the following factors:
   - DEI being a low priority on the agenda compared to other governance issues;
   - a failure to attract diverse talent; and
   - the risk of virtue signaling or DEI becoming a box-ticking exercise.

   Collecting and storing DEI data, and which benchmarks to follow, were also challenges identified; for example, 68% of respondents do not follow any major DEI standards.

4. Education is the first step towards DEI best practice and PT firms are leading from the front in terms of driving DEI training and implementing zero tolerance policies. Over half of PT firms (54%) have conducted or are planning to arrange diversity and inclusion training as part of their efforts to improve DEI. Meanwhile 38% have established a formal zero-tolerance policy for harassment or bullying.

The report set out the following recommendations for trustees:

- Develop a DEI knowledge base before setting policies and KPIs by focusing on understanding DEI issues and learning from experienced providers and sponsors.
- Follow best practice guidance from resources like the Diversity Project and National Equality Standard.
- Work with PTs to improve DEI, especially if resources are limited.
- Simpler and more inclusive communications for members.
- Start collecting data to monitor your progress on DEI; and
- Keep an open mind, and actively encourage, diverse views for better governance and decision-making.

You can read the full report here.

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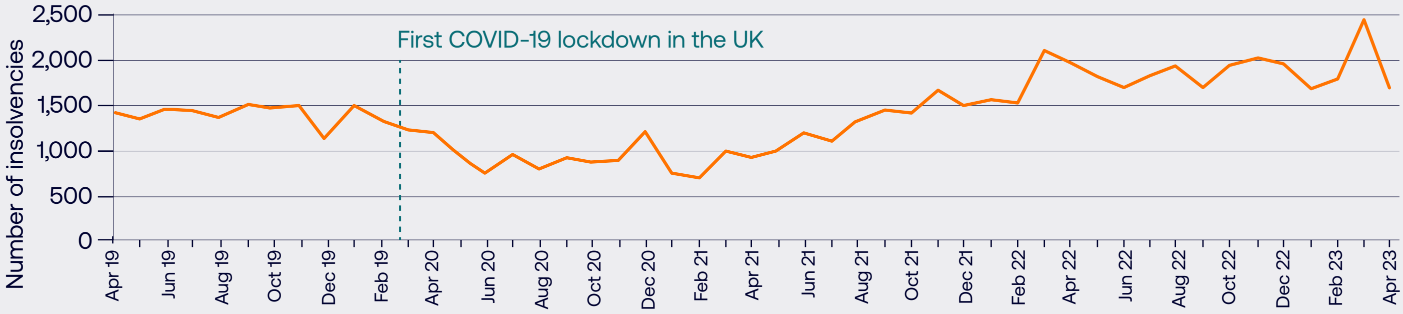
Datawatch: Long term trend shows insolvency cases are on the rise

Monthly company insolvencies (UK)



Source: Monthly Insolvency Statistics, April 2023, The Insolvency Services

The April statistics show a reassuring fall in the number of companies being declared insolvent, down 15% compared to this time last year and down just over 30% from March this year. However, we must remain cautious as one month does not make a trend and the impact of the cost-of-living crisis on consumer spending and tougher economic conditions for businesses continue.

Defined benefit (DB) scheme sponsors with volatile input costs (e.g. energy costs) or those that rely heavily on consumers' discretionary spending are coming under increasing pressure as both supply and demand squeeze profit margins and cash flows. Consequently, an increasing number of owners of SMEs are deciding to close down in such a turbulent trading climate.

High-interest rates are expected to persist given the stubbornly high inflation, which puts refinancing pressure on companies with approaching debt maturity. DB sponsors will most likely be asked to pay higher interest costs and provide greater lender protections, which may directly impact affordability of deficit recovery contributions (DRC) payments and potentially the scheme's access to value in an insolvency.

TPR's latest guidance on dealing with distressed sponsors emphasise the importance of timely contingency planning. To do that, Trustees need to ensure they have access to the latest management information and be on the lookout for distressed indicators. As well as staying vigilant and protecting members' interests, trustees should work closely with management teams to find pragmatic solutions to help sponsors during a crisis.

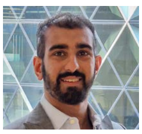
Ask the Analyst: How could collective defined contribution (CDC) schemes impact the pensions landscape?

In a first for UK pensions, The Royal Mail CDC scheme has been approved by TPR.

CDC schemes provide member benefits that have both Defined Benefit (DB) and Defined Contribution (DC) elements. CDC schemes target benefits in retirement funded by fixed contributions from employers and members. Contributions are pooled into a central fund, unlike DC where they are paid into individual pots. In retirement, pension payments vary so that the scheme remains fully funded, removing sponsor covenant exposure, unlike DB where benefit payments are guaranteed and employer contributions vary to fulfil deficits.

CDC schemes are advantageous to employers that wish to provide members with a secure income in retirement, but do not want to bare the investment, inflation and mortality risk of DB. Compared to DC, members have improved security in retirement and benefit from the pooling of these risks, but remain exposed to them collectively, unlike DB.

Although CDC schemes are in early stages, trustees should be cognisant of them especially if a sponsor is considering a benefit change exercise.



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Regulatory developments: TPR's 2023 Annual Funding Statement (AFS)

The AFS lays out TPR's expectations of trustees and sponsors for the year ahead, including:

1. **Being wary of covenant complacency:** While many schemes have benefitted from recent improvements to scheme funding levels, this could change, and in many cases, macroeconomic factors are continuing to put sponsors under pressure.
2. **Tailoring your covenant advice to your circumstances:** Trustees should tailor how they look at covenant to reflect their scheme's circumstances, and covenant analysis should evolve as a scheme progresses along its journey. For example, the shift of focus from recovery plan affordability to longevity of covenant for well-funded schemes is an important development in covenant thinking.
3. **Considering carefully before agreeing to reduce contributions or release contingent assets:** Sponsors may ask trustees to reduce contributions or release contingent assets where schemes have become well-funded, or in cases of distress. TPR urges trustees to carefully consider any such request in light of scheme and covenant risks, noting improved funding levels could reverse if not locked in.

The AFS appears to factor in some of the industry feedback on the draft Funding Code, providing more nuanced commentary on covenant and integrated risk management.
Find out more here.

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