Smith & Williamson

Pension Trustee Bulletin

FOR OCCUPATIONAL PENSION SCHEME TRUSTEES AND THEIR ADVISERS

ISSUE 2019

In this issue

Foreword

Welcome to our latest Pension Trustee Bulletin. It remains a sad inevitability that, while women are achieving equality in many walks of life, on pension provision, they still lag considerably. On average, a woman's total pension pot will be about one-fifth that of a man, thanks to a combination of poorer salary, career breaks and slower progression. We look at some ways this gap can be addressed.

Schemes are also having to calculate the effects of inequality of benefits between men and women since 17 May 1990 following a 2018 landmark case in the High Court. We look at the impact this is having on both scheme and employer accounts.

With trustees having the ultimate responsibility for the scheme accounts in which a liability might be included, we provide you with a checklist of questions to help you assess your auditor's work on these accounts.

A spotlight has also been focussed on making improvements in equality at work by HM Treasury's Women in Finance Charter, which seeks to improve gender balance within the financial services sector. We get the views of three women who work in the pensions industry on the changes they have seen in respect of equality over their careers.

Your scheme may have a life assurance and death in service benefits scheme attached to it. We look at how you can get the best value for money for the scheme and employer.

Please remember that we are here to help. Our assurance experts, employee benefit consultants and covenant advisers can help set you on the right path and support whatever challenges may arise in your scheme's future journey.

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Mind the (pensions) gap

Women may be achieving equality in many walks of life, but on pension provision, they still lag considerably. On average, a woman's total pension pot will be about one-fifth that of a man, due to a combination of lower salary, career breaks and missed opportunities.

The Chartered Insurance Institute found in October 2018 that the average pension wealth for women at age 65 is £35,800, one-fifth of a man's at the same age and a fraction of their financial needs even if they don't need end of life care. To put this in income terms, a woman's average pension pot would buy a retirement income of just £1,704, while a man's would bring £8,520.

These are averages, but even at the higher end, we see poor recognition of the importance of women's pensions. Even though it is tax efficient for married couples to use both pension allowances every year, particularly given the restrictions on tax relief for high earners, it is not a priority for many.

On the following page we look at how different approaches to saving can make a difference to women's outcomes in retirement. At one end is 'Jane', who is risk averse and uses lower risk options for the majority of her savings pot. She goes back to work part-time after her two children are born and saves 10% of her salary. In this scenario, with portfolio growth of 3% per annum, she runs out of money just 3 years into her retirement.

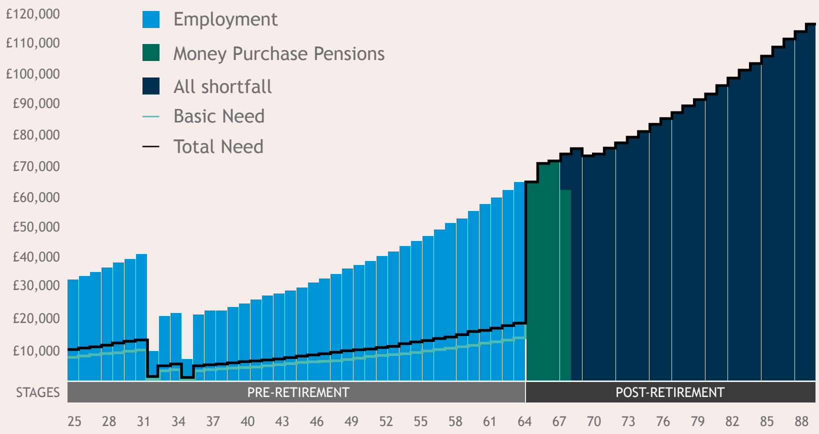
At the other end of the spectrum is 'Angela' who returns to work full time after her two children are born, saves 20% of her salary and achieves an investment return of 6% per annum. She manages to achieve a secure income in retirement and her pot should last for her full life expectancy of 89.*

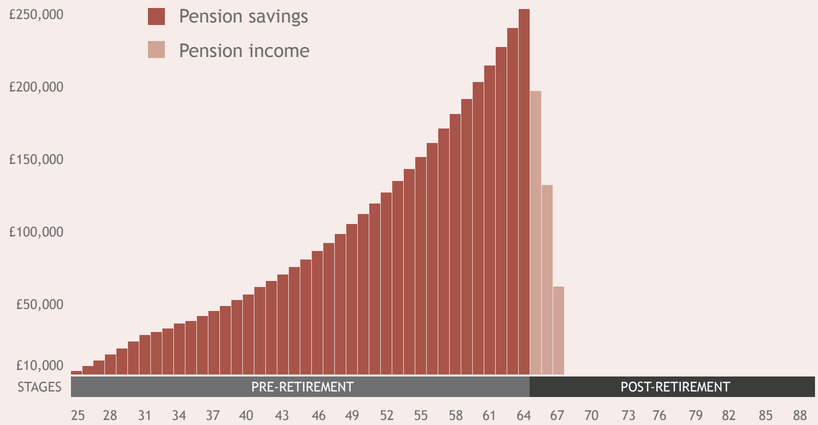
When contemplating retirement income, there are a number of key variables. First, it matters how much goes in the pot. This seems self-evident, but there was a time when pension schemes were based on final salary at retirement. Companies have largely abandoned these schemes as they were costly to run and now it is all about contribution levels.

The pension gap is often exacerbated due to women tending to earn less. The gender pay gap for the year to April 2018 for full-time workers was 8.6%. This is down from 9.1% in the previous year, but still represents a sizeable difference. Pension contributions from employers are usually based on a percentage of salary, so this matters for overall pension savings.

Case study: Jane and Angela

Please see case study assumptions overleaf





Jane

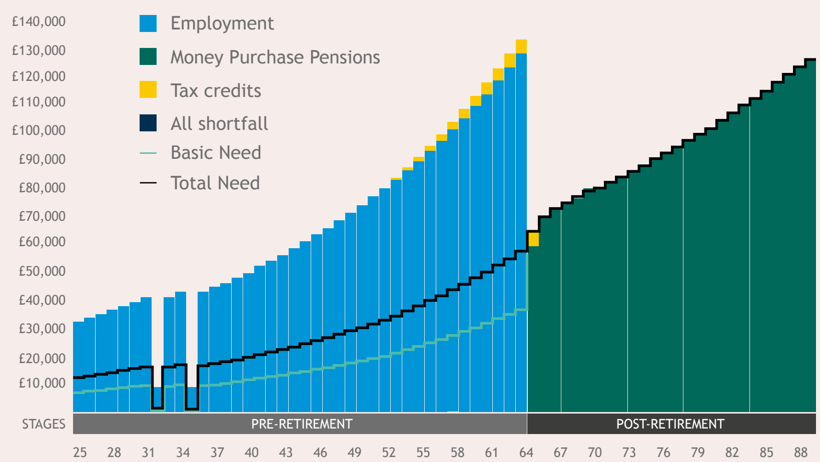
Investment type: Cautious portfolio

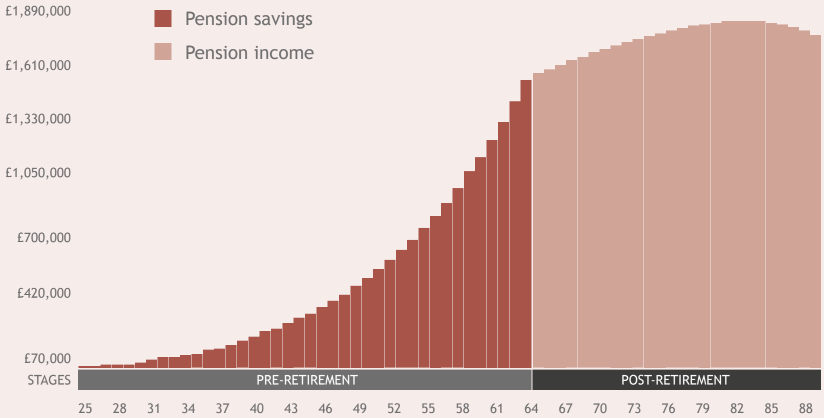
FT/PT: She goes back to work part-time

Savings contribution: 10% of her salary

Portfolio growth: 3% per annum

Result: Runs out of money just 3 years into her retirement.





Angela

Investment type: Balanced porfolio

FT/PT: She goes back to work full-time

Savings contribution: 20% of her salary

Portfolio growth: 6% per annum

Result: Achieves a secure income in retirement and her pot should last for her full life expectancy of 89*

Also problematic is that more women than men tend to work part-time after having children. This not only means they are paid less, but it can also stall their career progression. By the time a first child reaches 20, mothers earn almost a third less, on average, than similarly-educated fathers, according to February 2018 research from the Institute for Fiscal Studies (IFS) undertaken for the Joseph Rowntree Foundation.

Even if women do return to work full time after having children, they may see a reduction to their pension contributions during their maternity leave. This can dent their overall pension pot. Contributions will only be paid as a percentage of annual salary, which can be lower during maternity leave, depending on the firm's maternity policies.

Any gap or fall in contributions can have an important compounding effect. If a woman loses, say, £10,000 in contributions and does not make it up, this could equate to a circa £43,000 loss (assuming a growth rate of 5%) in their final pot 30 years later.

There are lessons to be learned here. The first is to keep contributions as high as possible for as long as possible. That means starting early and keeping contributions going through maternity leave or other career breaks. This may mean contributing to a wife's pension pot during these breaks for married couples. This can also be a tax efficient way to approach it and seeking financial advice regarding this matter is recommended.

The benefits of starting to save early should not be underestimated. Recent research from Fidelity shows how this can make a difference. It showed that Investor A, invests £1,000 a year into the stock market from the age of 18 and keeps doing so for the next 20 years. By the time they reach 38, and based on an annual return of 5%, their investment would be worth £34,719. If they were to make no further contributions, but their investments continued to grow at 5% return each year, by the time they reach 65, their investment would have grown to £129,623.

***Case study assumptions**

The case study figures are given for illustrative purposes and are not necessarily representative of future performance

Jane and Angela starting salary - £32,680

Jane and Angela start work and pension contributions aged 25

Salary increases – 4%

After returning from maternity leave

Part-time – 50% of salary prior to going on leave

Full-time – 100% of salary prior to going on leave

Maternity pay calculation – paid for 39 weeks. 6 weeks at 90% of weekly salary; £145.18 for 33 weeks; 13 weeks unpaid.

Pension calculations: Full time – 50% of final salary each year, inflation-linked at 2.5%. Part-time – 100% of final salary each year, inflation-linked at 2.5%

Sources:

'Annuity rates set for second successive year of rises' - FT Adviser, 7th August 2018
www.ftadviser.com/pensions/2018/08/07/annuity-rates-set-for-second-successive-year-of-rises

'Women Investing: What are the hurdles?' – MHP, 17th July 2018
www.mhpc.com/wp-content/uploads/2018/07/Women-investing_what-are-the-hurdles.pdf

Institute for Fiscal Studies (IFS) undertaken for the Joseph Rowntree Foundation – 5th February 2018

The Chartered Insurance Institute's (CII) *'Insuring Women's Futures'* – 24th October 2018

In contrast, Investor B, doesn't start investing until they are 38. Even if they invest the same £1,000 a year and achieve a 5% per annum return, they can't catch up. At 65, Investor B's portfolio is worth £57,403, less than half of investor A's. Starting early is vital for women if their earnings are likely to become less predictable later in life.

Another variable is investment risk. Women are often reluctant investors – outside their pension, just one fifth of women have any investment portfolio at all, compared with 33% of men. 52% of women prefer to look at low risk investments despite being aware they will receive lower returns, compared with just 36% of men. Just 0.7% of women prefer taking a higher risk with their savings to gain from better returns in the long-run.

> ...keep contributions as high as possible for as long as possible.

This is a problem, particularly given lower contribution rates. A monthly contribution of £1,000 over 30 years, growing at 6% per annum gives an overall pot of £1,004,515. The same contribution over the same time period growing at 3% per annum gives a pot of £582,737. Investors are almost halving their retirement income. The reality is that no matter how scary it feels to watch the capital value of a pension pot bounce around, this is a long-term investment. Contributions are often made monthly, so even if the capital value is falling, those contributions are being invested at a lower level. This should help smooth volatility over time.

There is no magic formula to improving women's retirement outcomes. It should improve as the gender pay gap closes and auto-enrolment rates rise. However, it won't happen by accident. It is important to recognise the role that contribution levels and investment growth play in building a pension pot over time. ■

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GMP Equalisation – The story so far

Following a High Court judgement in late 2018, there has been a flurry of activity by schemes and employers to assess the effects on their liabilities of equalising benefits for inequalities between males and females in respect of Guaranteed Minimum Pensions (GMPs) between 17 May 1990 and 5 April 1997. Guidance was issued by the Pensions Research Accountants Group (PRAG) in March this year that gives advice on the effect of these calculations on pension scheme accounts.

In broad terms, the financial impact can be summarised as:

1. A liability representing past underpayments (to pensioners and dependants)
2. A liability representing higher benefits in the future (to active, deferred and pensioner members and their dependants)

The sum of 1 and 2 should be accounted for in the defined benefit obligation in the employer accounts.

In accordance with the PRAG guidance, the first of these should be included in pension scheme accounts of the first period end after the court decision (26 October 2018) unless they are deemed to be immaterial. The second of these will only be dealt with through the scheme's Report on Actuarial Liabilities.

It has been estimated that the combined financial impact of 1 and 2 is somewhere between 1 and 4% of scheme liabilities for some schemes.

Of this, only part is from the past underpayments and there have been no estimates made of this to date. We have yet to see any scheme accounts including an adjustment, as the effect of past underpayments, has generally been determined to be immaterial.

We have seen employer accounts including the overall effect on their pension obligation as the constructive obligation for the employer arose on 25 October 2018. As most employers had not already included an estimation of the effects of equalisation, this is adjusted for as a plan amendment (without waiting for a scheme rule change - as the High Court ruling created the obligation) and accounted for as a past service cost (in the income statement).

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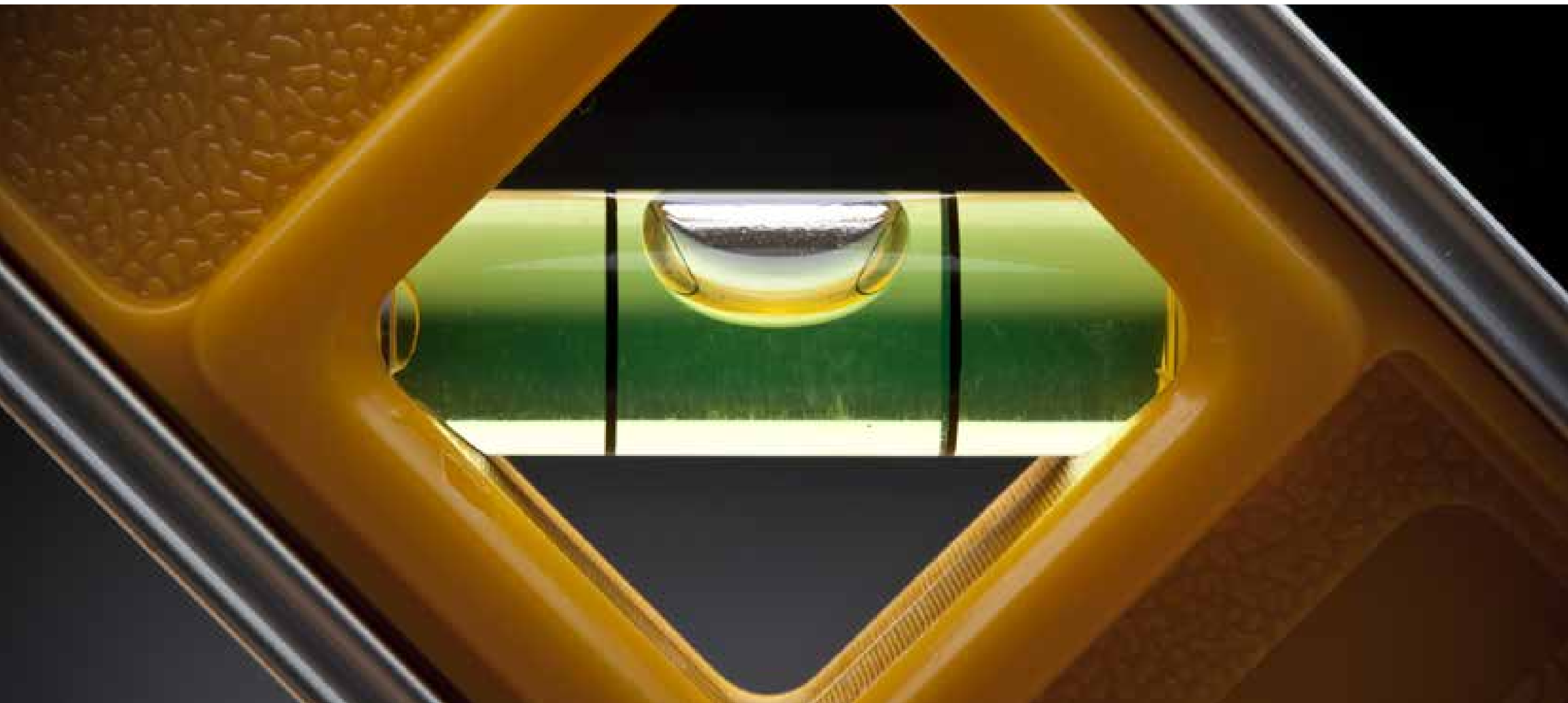

Questions for your auditors

Trustees are ultimately responsibility for their scheme's financial statements. Therefore, it is critical that trustees are certain of the quality of the audit process that has taken place on those financial statements by evaluating the performance of the audit team, the quality and honesty of their communications with trustees and scheme management and the auditor's independence and objectivity.

We have set out below some questions that trustees should consider asking their auditors to ensure that they receive a robust and value-for-money service:

Audit planning meeting or before the audit starts

- What is the planned scope of your audit? What balances and transactions will you be auditing?
- How does this differ from last year?
- Are there any concerns with how the administrators/pensions department control key scheme processes?
- What criteria do you use to determine materiality?
- Are there any activities that will not be audited that present operational or financial risks but are not viewed as material?
- How can your planned approach be relied upon to detect material frauds, errors or weaknesses in internal controls?
- Are there any areas the trustees or scheme administrator/pensions department could be of greater assistance to reduce the amount of time spent by you (and hence, reduce your fees)?
- Who will be carrying out the audit and what experience of pension schemes do they have?
- How much involvement will there be from the engagement leader?
- Are there any proposed changes to the Pensions SORP or accounting standards that will affect the scheme's accounts this or next year?
- How do you ensure you are independent?

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Audit reporting meeting or before the trustees sign the accounts

- Did the scope of the audit vary from that planned and how did it vary?
- Did you find any areas of the control environment that concerned you? If so, what are they and what are your recommendations for rectifying any issues?
- Have weaknesses in internal controls reported by you last year been rectified?
- Was the scheme administrator/pensions department receptive to your recommendations in respect of internal controls?
- Did the administrators/pensions department try to impose any limitations on your work?
- Did you detect any material frauds or errors and what were they?
- Are there any unresolved issues for your audit?
- Did you have enough time to complete your work?
- Is your audit opinion unqualified? If not, why?
- Is your statement about contributions unqualified? If not, why?
- Were there any disagreements over accounting, auditing or reporting matters between you and the scheme administrators/pensions department and accounts preparers?
- How did you satisfy yourselves as to the reasonableness of the annuity/buy-in policy valuations?
- How do our accounting policies compare to industry best practice?
- What is your assessment of the integrity and competence of the scheme administrator/pensions department?
- How do your costs compare to the estimated fees?
- What are the advantages to the trustees of continuing with your firm as scheme auditors?

Women in pensions

As part of our diversity and inclusion commitment, Smith & Williamson is proud to be a signatory of HM Treasury's Women in Finance Charter, which seeks to improve gender balance within the financial services sector.

Signatories to the Charter pledge to support the progression of women into senior roles, set measurable targets and to report publicly on delivery against the targets each year. Of our pensions assurance team, 50% of the senior team members are women.

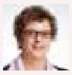
The pensions industry is traditionally seen as lacking in diversity and lagging behind the general corporate environment. We asked three women who spend their working lives in the sector for their thoughts.

Julia Ridger
Partner, Smith & Williamson Financial Services Limited

Kim Nash
Independent Trustee, Pitman Trustees Limited

Suzan Myumyun
Audit Senior, Nexia Smith & Williamson Audit Limited

1. What brought you into pensions?



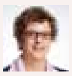
JR: My Godfather worked at a pension and life assurance company close to where I lived and suggested I interviewed for a vacant post after leaving college. I joined as an administrator where I dealt with defined benefit pension schemes and the attaching risk benefit arrangements. I have been in pensions ever since. You could say I fell into pensions but I was following the profession of my father who had worked at Standard Life all his career.

KN: I came into pensions after completing my maths degree and then choosing to train as an Actuary so I could use this experience.

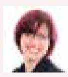
My current role as an independent trustee came after I qualified as an Actuary and I wanted to be more involved with the most enjoyable parts of my work: meeting with and helping clients.

SM: My first job in pensions wasn't really a planned career move, it just happened. However, I chose my next (current) job because it took me into a pensions-related area I really wanted to specialise in which is audit.

2. What changes have you seen in the treatment of women in the pensions industry over your career?



JR: When I joined the pensions industry, other than administration support, senior appointments, consultants, trustees and actuaries were predominately men, A woman holding a predominant role was rare. It's only in the last 15 years or so that there has been a shift towards embracing the skills women bring to the industry and supporting them to reach positions of prominence. As well as women striving to achieve the professional qualifications to support them on their journey they are now been recognised for their management, relationship building and new business skills as well as their leadership qualities which was not the case previously.



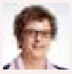
KN: As I mentioned, I had a radical change fairly early in my career to become an independent trustee. At that stage, most other independent trustees were towards the end of their careers and overwhelmingly male. So, I definitely looked different to the typical trustee as I was younger and female!

I also had to work much harder to get over the "you're not what I expected" views I encountered with clients and potential clients.

However, I believe that there are more opportunities now for women and younger people generally. Many new business pitches are specifically asking for women candidates and there are many more women taking lead advisor roles for schemes. Something that was rare when I started out in pensions.

SM: My first role was at a firm with a male only manager group with a conservative culture. So, it made a very pleasant change to find a mix of genders in all roles at Smith & Williamson.

3. What do you think have been the positive and negative impacts on your career of being a woman?



JR: Key positive impacts are firstly, the ability to empathise and use my emotional intelligence to build trusted relationships quickly. The other is from a networking perspective as there is less of presence of women within the industry. This has opened up a wider number of opportunities to attend events and interact with key figures within the pensions industry and other supporting professional practices.

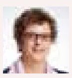
Key negatives are that I undoubtedly received less financial reward through my early working career and that I have also had to work harder and longer over the years to achieve recognition and advance my career.

KN: On the positive side, being a woman certainly helped those I met remember me as most others in the independent trustee sector are still male. It has also brought with it a different perspective and energy level.

I have had to work harder to gain respect as, being a woman, I didn't fit peoples' preconception of what an independent trustee looked like. There is also the challenge of juggling family and professional lives.

SM: I haven't noticed being treated any differently because I am a woman. However, I feel my career is moving more slowly compared to male colleagues as I'm trying to balance family and working life. This isn't a pensions specific issue though!

4. Who has inspired you and why?



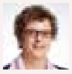
JR: I was inspired by Sarah Jeffery-Gray who in the late 90's achieved a senior professional role within the pensions industry and was a leading voice, with whom I worked with on a number of appointments.

Ian Hartnell, who had faith and confidence in me to open up the possibilities of a long career at Smith & Williamson and who supported me and pushed me to achieve. He was a highly innovative thinker and had a second-to-none knowledge on corporate pensions.

KN: Rather than inspiring me there have been those who have encouraged me in making the next step in my career and given me confidence in my own abilities.

SM: Both my parents were accountants so, unsurprisingly, I was exposed to what this involved at an early age. Especially as my Dad had an office at home into which I would have to go if I wanted to speak to him some weekends! Dad did inspire me to follow in his footsteps.

5. What do you see as the challenges for women in pensions in the future?



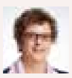
JR: There continues to be a number of older men in the industry and sponsoring corporate who still have tunnel vision when it comes to the professionalism of women and their ability within the industry. It may be a further 10 -15 years from now where we see a final trend to women being considered equally for senior appointments, lead consultancy roles and as Trustee Chairs, once the older generation finally step away from the industry.

KN: The pensions industry has got to change its approach as current communications with members is not working. Mainly, I think, as current trustee boards do not know what members want as they are unable to relate to their needs.

Women and younger people are in a better place to understand the needs of these demographic groups and design appropriate communications.

SM: Despite the Government's initiative, I believe that there is still gender inequality in businesses generally. The reporting about the gender pay gap by larger companies is placing focus on this inequality and, I think it will result in more women getting senior positions. However, notwithstanding this, it is still work-in-progress.

6. What do you think the challenges are to improve diversity and inclusion in the pensions industry?



JR: With the continuing contraction of the pensions industry there are less opportunities for everyone Through AI and technology advancement the servicing of pensions is changing. There will therefore be the need for more diversity in the skill sets need to service the industry. However the remuneration packages offered and the industry appeal, may impeded the ability of companies to hirer the "cream of the crop". The Pensions' Industry is slowly coming into the 21st Century but the word "Pensions" is still seen as a dull and uninspiring.

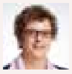
KN: The pensions industry as a whole is not diverse although improving this should not just be a 'box ticking' exercise.

It is great that there is more discussion around diversity and inclusion in the industry and I have seen efforts to improve this. However, we should be careful to have diversity of thinking as well. You could have a trustee board, for example, that might look diverse but could all think in the same way. I believe that 'Group think' in this way is a bigger threat to the future success of the industry than diversity and inclusion in itself.

There is also the fact that people have describes the pensions industry as "dying" for decades. From my point of view, this is certainly not true and discourages people from entering what can be a very interesting and fulfilling career. We should be encouraging people to enter the industry and be positive about what this can bring to their careers.

SM: I think the main challenge is to attract and retain people working in pensions generally, not just women. Unfortunately, a career in pensions might not excite many young people, even though it is a growing industry with lots of career opportunities.

7. What advice would you give to a woman just starting out in their pensions' career?



JR: Work hard, obtain your qualifications, use your emotional IQ to build and strengthen relationships and ensure you have a structured networking approach. Build long lasting relationships with people who you enjoy spending time with and can talk to about your life, not just about pensions!

KN: Have confidence that you have valuable skills to bring to the role you take on and that you will have a voice round the table.

There has been a massive shift in independent trusteeship in the past five years so make the best use of this going forward.

SM: Work hard, be yourself and be confident.

Have you looked under the bonnet of your attaching Group Life Assurance and Death in Service Scheme?

Whilst it is important for an employer to be seen to provide a ‘good’ employee remuneration package, many fail to properly communicate, manage and control their schemes. This leads to employees’ significantly undervaluing the package and the employer receiving a poor return on their expenditure.

Defined benefit pension schemes usually have an attaching group life assurance and death in service pension scheme running alongside, which provide cover to the current employees and existing scheme members.

As the premiums are funded by the employer and the trustees are focused on the running of the defined benefit pension scheme, we regularly find that the attaching life assurance arrangements can be overlooked.

The administration of these arrangements may not be as robust as under the defined benefit pension scheme, as it is often not monitored or administered with the same level of detail. For example there can be time drag on provision of renewal data and submission to the insurers. A review can sometimes uncover failure in the membership data provided and in certain instances members' levels of cover.

A review can also uncover the failure of the insurer to provide the correct level of cover in accordance with the trust deed and rules of the attaching defined benefit scheme. This puts the trustees at immediate risk, for failing to insure the necessary levels of cover.

It also allows the employer and trustees to consider the potential restructure of the arrangements, and we are seeing a growing trend to a move to a multiple of salary as replacement for death in service pension benefits.

At Smith & Williamson we provide an insight review service for employers and trustees looking under the bonnet of the attaching group life assurance and death-in-service scheme. Through initial discussions with the employer and trustees we identify a number of key areas for investigation such as:

- A review of the Group Life and Death–in-Service scheme policy benefits against the Trust Deed and Rules to identify any discrepancies and ensure consistency.
- A review of the premium history and unit rate to uncover any anomalies, and identify any tendency for rate creep.
- We identify claim history and determine areas of favourability which could be leveraged to improve terms and provide cost savings.
- We consider change that will ensure the life assurance scheme is aligned with pension legislation & best practice.

We recently carried out such a review for one of our existing clients and highlighted a number of potential improvements that are now being considered these included:

- Potential cost reductions on the existing premium under the group life scheme of over 10%.
- Consideration to replace the existing group life scheme which is a Registered scheme, with an Excepted group life policy.
- Further potential savings on the premium payable for providing death-in-service cover.
- Potential restructure of the death in service pension scheme to provide an additional lump sum equivalent, rather than a death-in-service pension.

Smith & Williamson recognises that every employer with a group life assurance and death-in-service arrangement in place will have a number of different facets and nuances to the structure of the arrangement. This is why our review service is bespoke and tailored to the needs and objectives of the employer and trustees.

With greater insight into the unique challenges and opportunities we can better identify the strengths and weaknesses of the existing arrangement and explain and propose how it could potentially operate better tomorrow.

If you want Smith & Williamson to carry out a review please do get in touch.

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Our expertise

For over a century, we have managed the financial affairs of private clients and their business interests.

With over 1,700 people in 12 offices in the UK, Ireland and Jersey, we are a leading investment management business and one of the UK's ten largest accountancy firms *(Accountancy Age, 2018)*

Clients, whether individuals or companies, value our ability to provide tailored financial and professional services to enable them to achieve their ambitions.

Business services

- Assurance and accounting
- Business tax
- Corporate finance
- Corporate trustee services
- Forensic accounting and litigation support
- Fund administration
- Pensions and employee benefits
- Restructuring and recovery

Private client services

- Fund management
- International
- Investment management
- Pensions and personal financial planning
- Private banking
- Strategic advice
- Tax and trusts
- Tax investigations
- Trustee and executorship service

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