

Governance

STUDY TEXT

MAPPED TO THE OFFICIAL PMI SYLLABUS
AND LEARNING OUTCOMES

QUALIFICATIONS

About the PMI

Founded in 1976, the PMI is the UK's largest and most recognisable professional body for employee benefit and retirement savings professionals, supporting over 7,000 members.

PMI's members, represented throughout the UK, are responsible for managing and advising some of the largest institutions in the world accounting for £1.3 trillion invested in pensions. We promote excellence through a range of services for the benefit of members, the wider economy and with over six million now saving as a result of automatic enrolment, society as a whole.

The mission of the PMI is ***"to deliver exceptional thought leadership, comprehensive education, advanced training, and recognised qualifications in pension management. With this, we are committed to fostering industry collaboration and driving innovation to enhance retirement outcomes".***

To achieve this, the PMI is:

- **Always forward-thinking**
  Our commitment is to support our members and partners in creating better retirement outcomes by leading the way in industry innovation and development. By fostering continuous learning, professional growth, and leadership, we empower our members to drive meaningful improvements and ensure sustainable, high-quality pension outcomes for the future.
- **Preparing the next generation**
  We will continue to ensure that future professionals and leaders in our industry have both the technical and leadership skills necessary to deliver high-quality, transformational pension fund management that adapts to and supports the financial needs of members throughout their lifetimes.
- **Shaping the future of pension outcomes**
  We will continue to collaborate with our members, stakeholders, and Westminster to influence and enhance policies and practices, ensuring sustainable and better outcomes for scheme members
- **Responding quickly to a changing world**
  We continually strive to improve practices within workplace pensions to help build better financial wellness. By setting ambitious standards, building a trusted pensions environment, we support our members in delivering better retirement outcomes and improved financial wellness for today and tomorrow.
- **Focusing on member-centric solutions**
  Scheme members are at the heart of our mission. We will continue to support the industry in developing solutions that adapt to the realities of living longer, retiring later, and our multicultural society – actively promoting a lifetime savings model that meets these evolving needs.
- **Empowering informed decisions**
  We believe it's crucial for scheme members to make informed decisions and engage in planning their financial future. We will collaborate with and encourage our members, partners, and stakeholders to develop innovative and effective strategies that empower scheme members to make informed decisions about their choices up to and at retirement.
- **Promoting excellence and inclusivity**
  We will promote best practices and standards within the pensions industry, prioritising ESG and fostering diverse thinking and inclusive practices.
- **Being committed to your success**
  We are dedicated to our members' success. Through education, guidance, and creating opportunities, we will continue to support career progression and the success of our industry partners. We will champion your personal growth, staying relevant to your present needs and preparing you for the future.

- **Promoting education and qualifications**
  We will strengthen our position as the leader in pensions education and qualifications—championing high-quality professional learning and ensuring our programmes remain relevant and valuable for students and the wider pensions profession.
- **Leading source of knowledge and information**
  We will gather the best and most relevant knowledge and information to keep our members updated and informed, supporting continuous professional and personal growth.
- **Actively facilitating partnership and community**
  We are committed to building inclusive communities that unite a diverse spectrum of professionals from across the industry. Our goal is to support and share best practices, encourage robust debate, foster collaboration, and deliver innovative change.
- **Champion professional standards**
  We will continue to lead, champion, and promote the importance of professional standards, positioning our members and accredited trustees as trusted and respected.

A word about PMI Qualifications

The PMI is the UK's leading professional body for those working in the field of employee benefits and retirement savings. It supports and develops the experts who are responsible for running the UK's pensions industry and is acknowledged as the body for establishing, maintaining and improving professional standards in every area of pension scheme management, consultancy and trusteeship.

PMI qualifications are recognised for both their depth and their standing within the industry. If you choose a single unit, standalone qualification, or a multi-unit qualification over a number of years, it is recognised by the Pensions Industry as having the depth and rigour to demonstrate the knowledge and expertise of those taking them.

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Andrew is Director of his own ICAEW registered firm Resilient ESG Governance Services Ltd; and is a qualified Chartered Accountant with the PMI Advanced Diploma in Retirement Provision and PMI qualifications in DC Governance, Retail Investment Advice and Regulation, and accredited member of the professional trustee body APPT. As a member of the ICAEW Assurance Panel since 2006, Andrew reviews

all assurance technical releases and has taken part in working groups in emerging governance good practice with the ICAEW, the Pensions Regulator and the Pensions Research Accountants Group (PRAG). Andrew is a member of PMI London and has a keen interest in driving forward the Environmental, Social and Governance agenda in pension investments through action-led informative communications.

Foreword

Undertaking a rigorous professional qualification requires commitment and ongoing development. The PMI Competency Framework provides a clear structure to help you assess your current skills, identify development needs, and plan your professional development and career progression.

By engaging with the Framework alongside your qualification studies, you can consider how the knowledge and skills you are developing relate to the wider requirements of the pensions profession. It provides a practical way to connect your learning with recognised professional competencies and to identify areas where further development may support your career goals.

Why the Competency Framework?

The PMI Competency Framework sets out the technical and behavioural competencies required for success across different levels of the pensions profession, from Support and Supervisory roles through to Manager, Senior and Strategic leadership roles. Developed in consultation with industry, it covers key functional areas including Strategy and Policy, Operational Management, Leadership, Compliance & ESG, Trusteeship and more.

Benefits include:

Clear career progression:
Understand the expectations associated with different career stages and use these to help plan your professional development.

Targeted skill development:
Identify your strengths and development areas so that you can focus your learning on the competencies most relevant to your role and career aspirations.

Connection to PMI qualifications:
Use the Framework alongside your PMI qualification to understand how your learning can contribute to the development of the knowledge and competencies required within the pensions profession.

Industry recognition:
Developing and demonstrating relevant competencies can strengthen your professional credibility and support your contribution to positive outcomes for pension savers.



The Competency Framework forms an important part of PMI's commitment to lifelong learning, professional development and maintaining high standards across the pensions profession. We encourage you to use it as a practical tool for self-assessment, development planning, performance discussions and continuous improvement throughout your career.

Further information about the competencies and how they relate to PMI qualifications can be found on the **PMI Competency Framework webpage**.

If you have any questions or feedback about the Competency Framework, please contact the PMI Qualifications team at **pmiqualifications@pensions-pmi.org.uk**

Preface

Management of risk is a central topic for everyone involved in running pension schemes. Funding and communication risks for defined benefit schemes, and for members of defined contribution schemes and the different types of risks they bring. This has put a strong onus on those operating schemes to make sure they are run accurately and effectively, with careful attention paid to the various things that could go wrong, and the level of risk attached to each.

This manual is for use within the Professionalism and Governance module which sits across every Pathway. It is part of the module all PMI Pathways undertake before they reach Associate Membership (APMI) and provides a synergy and context to delivering communications to the materials learned in the units taken to get to this point.

Further details on the units that comprise each Pathway and the work of the PMI can be found on the website. We hope you will enjoy studying with the PMI and we welcome feedback you would like to offer. This feedback should be directed to the Qualifications Department at PMI: pmiqualifications@pensions-pmi.org.uk

To ensure that these risks are addressed as successfully as possible, the Pensions Regulator (Regulator) (TPR) has issued various pieces of legislation and guidance aimed at improving pension scheme governance which are published on its website **https://www.thepensionsregulator.gov.uk/en/trustees**. Environmental, social and governance (ESG) and business continuity and funding risks after the COVID-19 crisis and economic and fiscal events have come to the forefront as key risk areas to address too by the Regulator.

For pension schemes that are trust-based, as opposed to personal pensions, the duty to operate the scheme well lies primarily with the trustees. But a range of other people will be involved in operating the scheme. Some companies employ a pensions manager, and almost all pension schemes will rely on advisers and other providers to a greater or lesser extent. In their different ways they will all be expected to play their part in helping the scheme to manage its risks well and maintain good governance.



It is important for everyone involved in running schemes to understand the contributions that these different advisers and providers can make, and how their efforts need to be drawn together in order for the scheme to be run effectively. For anyone in charge of co-ordinating the work of these different individuals and companies, an understanding of project management, service level agreements and other commercial aspects of operating a pension scheme is essential.

Part 1 explores the risks that pension schemes face, and the approaches that trustees and others can follow in addressing these risks. It then explains the steps that the Pensions Regulator has taken to improve governance of pension schemes, the methods and structures that schemes are adopting in response, and the demand for externally accredited pension trustee certification.

Part 2 looks at how pensions departments, or suppliers to pensions department should be managed and how their activities can be controlled. It details the tools and mechanisms that can be used to measure and benchmark activities, and it explores how the views of members of pension schemes feed into the measurement process. It touches on the ways that typical organisational structures and controls influence a pensions department in terms of resourcing, planning and directing. There is also a section covering technology and how technology plays a part in the pensions industry.

Part 3 looks more widely at investment. It includes coverage of investment management and approaches to performance monitoring. This Part 3 contains content that is also covered in the PMI Core Unit 4 (PMI CU4) Financing and Investment for Retirement Provision.

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Syllabus

Aim:

To provide candidates with:

- an understanding of the importance of professionalism and ethics
- the importance of continuing their own professional development
- an appreciation of risk and governance issues as they apply to pension schemes
- the opportunity to demonstrate their ability to apply risk and governance principles in a practical situation
- evidence that they can communicate their knowledge in a way that is relevant to their audience.

1. **Demonstrate an awareness of the Professional Standards expected of PMI Members as set out in the PMI Code of Professional Conduct. Explain the importance of the following:**
- acting with the highest standards of professionalism and integrity
- providing a high standard of service
- acting in the best interests of each client
- treating people fairly regardless of race or racial group, sex or sexual orientation, religion or belief; age and disability

2. **Demonstrate an understanding of the importance of continuing personal development (CPD)**
- explain each of the following:
- Trustee Knowledge and Understanding (TKU) and training plan
- Trustee board requirements for appointment
- Trustee board competence methodologies
- continuing professional development and the requirements of the PMI and other professions

3. **Demonstrate an understanding of professionalism and business ethics. Explain the importance of the following:**
- corporate culture
- dealing with complaints
- conflicts of interest
- ethical dilemmas - identification, implications and appropriate behaviour
- whistle-blowing legislative requirements and the protections given to whistle blowers

4. **Explain the commercial aspects of operating a workplace pension scheme. Analyse each of the following:**
- nature of costs
- cost control
- budgeting
- contracts management and agreements

5. **Demonstrate an understanding of the management and measurement of service delivery.**
Explain each of the following:

- selecting, monitoring and changing advisers
- managing client relationships and quality assessments
- service level agreements and service provider reviews
- type, role and value of performance measures
- reporting
- contract remedies
- quality management systems and kite marks
- benchmarking
- member and client surveys
- complaint/dispute resolution

6. **Demonstrate an understanding of the importance of good governance in managing a workplace pension scheme.**

Explain the features of scheme governance

Outline the roles of the employer, trustees, providers, and employer and provider governance committees

Outline the importance of:

- risk management
- assessing value for members
- member communication, engagement and feedback
- investment and manager selection

Evaluate each of the following:

- structures/governance committees
- internal controls
- scheme documents including
- governance statement
- Chair's annual statement
- annual business plan
- trustee assessments and training records
- statements of investment principles
- documentation and record keeping
- relevant Pensions Regulator Codes of Practice and guidance
- data quality and data security
- reporting administration and core financial transactions
- selection, management and review of advisers and providers
- recognised industry standards e.g. ICAEW's AAF assurance, ISAE 3000, PASA, ISO 27001

7. **Outline factors taken into consideration when selecting, monitoring and changing investment managers. Explain each of the following:**

- identifying investment requirements
- manager selection processes
- custody and title of assets
- fee structures and fee disclosure
- setting investment performance targets
- ethical and socially responsible investment
- investment management agreements
- administration
- transition management
- monitoring investment performance and governance

8. **Demonstrate an understanding of internal controls**

- describe internal controls
- explain why internal controls are required
- describe the assessment of risk describe operational risk

9. **Explain the role of the trustees in managing risk**

- outline the process of governance review/risk management
- outline preparation and management of a risk register
- identify how to mitigate risk
- analyse the nature of de-risking
- analyse the role of the TKU requirements

Assessment Model for Governance



1. Exam Format

This exam unit uses the following variety of question types:

QUESTION TYPE	QUESTION TYPE DESCRIPTION	MARKS PER QUESTION
A	Short length answer questions where candidates write their answers in freeform	5-10 marks
B	Moderate length answer questions where candidates write their answers in freeform	15-20 marks
C	Full length answer questions where candidates write their answers in freeform	30 to 45 marks
D	"Scenario" type questions where candidates are presented with a scenario and requested to write a short answer to the question presented on the scenario	10 to 15 marks
E	Extended length questions where candidates are presented with a case study and requested to write a detailed answer	60 marks

The Compulsory "Professionalism and Governance" Unit of the Advanced Diploma will be assessed through questions of Types D and E as denoted in bold above.

1. **3 Type D** questions on matters relating to professionalism [syllabus items 1-3]. These questions will be based on the PMI Code of Conduct and illustrative case studies in the Professionalism study manual; 40 marks in total. 40% of overall mark
   - Recommended time allocation 1 hour
2. **1 Type E** question based on governance matters [syllabus items 4-9] as covered in the Governance study manual. 60 marks in total.60% of overall mark
   - Recommended time allocation 2 hours. Questions to include format / communications presentation element (approximately 20% of total)

2. Exam Duration — 3 hours

3. Pass mark — 55%



Part 1

PENSIONS RISK MANAGEMENT





OVERVIEW

As a society the UK is becoming more risk aware, and more risk averse. Trustees of pension schemes, like many others in the corporate world, have been greatly affected by these developments. Increasingly pension trustees are expected to meet high standards of governance, and this is reflected in various pieces of guidance from the Pensions Regulator (TPR) which make recommendations about how trustees and trustee boards can set about managing risk. TPR has also published numerous other pieces of guidance on risk for trustees of defined benefit (DB) and defined contribution (DC) schemes; and regularly issues comment through its blogs on its own website.

There are various types of risks that trustees need to address. These risks can be broadly categorised as operational, financial, funding, regulatory and compliance risks. TPR's Code of Practice 09: Internal Controls (November 2006) has helped set up the risk framework that trustees are expected to follow, and was replaced by the TPR General Code. This Code also replaced nine other previous codes No. 1, 4, 5, 6, 7, 8, 11, 13 and 14. TPR's Code of practice 15: Authorisation and supervision of master trusts (October 2018) set out more details on expected systems and processes for running and governing a scheme and its operations with 'Systems and processes' section (#99-129) as one of the five required authorisation criteria. This is against a background of increased scrutiny from other guidance for corporate organisations (e.g. the UK Corporate Governance Code, COSO and Sarbanes-Oxley laws, and GDPR regulations). The Code of practice 15 remains in force and is published in the TPR website 'Master trust authorisation' alongside headings from the general code such as 'The governing body'(**https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice**).

The TPR general code came into effect 28 March 2024 completing the consultation on the new single code of practice in May 2021, to produce a new legislative requirement for own risk assessment (ORA) and for a scheme having an effective system of governance and controls (ESOG).

Effective risk management is a vital tool in the proper management of a pension scheme and it is important to trustees that this is in place as it is valuable for their own protection. There are no right and wrong answers in terms of the process to be followed, and the guidance supporting the Code of Practice and other TPR guidance provide an excellent starting point. The important thing is that trustees do have an appropriate risk management strategy in place and, so far as possible, do not leave anything to chance.

Part 1 explores the above comments further, and looks at the various type of risk that trustees could encounter and explains the role of trustees in the risk management process, including the steps that trustees can take towards ensuring good risk governance.



CHAPTER 1

Introduction to Pension Schemes and Risk

INTRODUCTION

This Chapter provides an overview of risk and risk management in the context of pension schemes.

1.1 BACKGROUND: ATTITUDES TO RISK IN THE CORPORATE WORLD

1.1.1 The UK Corporate Governance Code And Internal Controls

The UK Corporate Governance Code was most recently published in July 2018 by the Financial Reporting Council (FRC) and is designed to help UK listed companies implement high standards of governance and encourage long- term investment. The first version was published in 1992 by the Cadbury Committee which defined corporate governance as 'the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place'.

The UK Corporate Governance Code requires UK listed companies to maintain a sound system of internal control, review the effectiveness of the system at least annually, and include a statement on internal control in the annual report and accounts.

It applies to all companies with a premium listing, whether incorporated in the UK or elsewhere for accounting periods beginning on or after 1 January 2019. It is supported by the Guidance on Board Effectiveness July 2018. The FRC also recommend a board should consider the FRC's Guidance on Risk Management, Internal Control and Related Financial and Business Reporting September 2014, and Guidance on Audit Committees December 2010. Details of these can be found at frc.org.uk and do not form part of the PMI syllabus.

1.1.2 COSO Risk Management And Sarbanes-Oxley

COSO (The Committee of Sponsoring Organizations) originated in North America in 1985 as an independent private-sector initiative to tackle fraudulent financial reporting. It provides thought leadership in three interrelated subjects: enterprise risk management (ERM), internal control, and fraud deterrence. With help from COSO, the Sarbanes-Oxley Act of 2002 (SOX) was passed as United States federal law to strengthen corporate governance and restore investor confidence.

The Sarbanes-Oxley law was a response to a number of major corporate and accounting scandals involving prominent companies in the United States. These scandals resulted in a loss of public trust in accounting and reporting practices. SOX compliance is still a legal obligation for all public traded companies in the USA as well as wholly-owned subsidiaries and foreign companies that are public traded and do business in the United States, such as UK companies that are subsidiaries of US parents. The SOX financial security controls are complimented by data processing, change management and security controls. External assessment of these can be in the form of a US standard on Service Organization Controls (SOC) audit that is known as a Statement on Standards for Attestation Engagements (SSAE 18). SOC 1 reports focus on controls relevant to a customer's financial statements. SOC 2 reports on service providers relate to operations and compliance controls in relation to five principles of Security, Availability, Processing Integrity, Confidentiality, and Privacy. SOC 3 is a public report of internal controls that can produced from a SOC 2 report without the details of the testing and test results. COSO Internal Control – Integrated Framework) is issued by the American Institute of Certified Public Accountants (AICPA) and do not form part of the PMI syllabus.

These principles are described in detail in the Trust Services Criteria (which include elements of the 2013 COSO Internal Control – Integrated Framework) is issued by the American Institute of Certified Public Accountants (AICPA) and do not form part of the PMI syllabus.

1.1.3 General Data Protection Regulation (GDPR)

The General Data Protection Regulation (EU) 2016/679 (GDPR) became applicable on 25 May 2018 to harmonise data privacy laws in the European Union (EU) and the European Economic Area (EEA). It also involves regulation of the transfer of personal data outside of the EU and EEA areas. Controllers and processors of personal data must have appropriate controls to safeguard the GDPR data principles and the rights of the data subject. With the United Kingdom leaving the EU little has changed to GDPR requirements. However, this is something to keep an eye on. The ICO (Information Commissioner's Office) has a useful update on the UK General Date Protection Regulation (UK GDPR) https://ico.org.uk/for-organisations/uk-gdpr-guidance-and-resources/

In effect this means that every process that is part of the financial operation of the company must be fully documented. This affects a range of departments across the company, not just those in the financial department. It has had a significant effect for not just for IT departments but also pension schemes and companies given that these businesses generate, exchange and store so much information electronically.

Businesses need to ensure that all key GDPR risks are identified and that the controls they have in place match those risks. Businesses also need to ensure that the key controls they have in place are tested and that any gaps they have in those controls are reported upon and closed.

1.1.4 organisational risk Management

In the light of the above developments in the corporate world, most organisations these days have a mechanism for managing risk. This may be through a risk management group, or a sub-committee of the executive or board of directors. There are also many different mechanisms for managing risk. This might include the following steps:

- promote risk awareness in the business. It is fundamental that everyone in the organisation, and not just those that sit on the board or are members of the risk management group, can recognise the importance of identifying risks and take ownership for minimising the exposure to those risks.
- identify possible causes and consequences of hazards in the organisation. Consistent separation of causes and consequences simplifies risk analysis and facilitates efficient risk handling.
- assess and evaluate the risks. The probability of the identified causes is assessed in terms such as "often", "frequent", "sometimes" etc. The severity of the identified consequences is assessed or similarly expressed in such terms as "catastrophic", "critical", "small" etc. This will also identify those risks that require action i.e. starting with those with highest probability and most severe impact.
- take action on the risks identified as priority. A systematic approach needs to be adopted which allows risks to be handled consistently according to their causes and consequences.
- use cause-related handling measures that avoid or reduce risks by diminishing the probability of their occurring.
- use consequence-related handling measures that are productive after a problem has occurred. It is then important to distinguish between measures that have a direct influence on the consequences
- reducing their severity, and that provide financial solutions to handle risks. The risks themselves remain unchanged.
- transfer risk. The risks themselves remain, resulting from the causes and potentially will produce the anticipated consequences. However, the financial consequences are transferred to another party or to an insurer or are financed in some way.
- retain the risk. Again, the risk still remains and solutions are found within the organisation to bear the financial consequences.
- integrate the process within the organisation. It is important to have a feedback mechanism and central to this is the flow of information from the risk management process. All information must be centrally gathered, analysed and fed back to the business, with a set procedure to review this information.

Risk management should become second nature to the senior team and the workforce, with the principle of continuous learning and improvement being applied.

1.1.5 IORP II, TPR Regulatory Guidance, Codes Of Practice and Code-Related Guidance

New requirements for pension scheme governance came into force on 13 January 2019 as part of the transcription of the EU IORP II Directive into UK law. (See Part 1 2.1.1).

The regulations placed new requirements on certain occupational pension schemes, the most far-reaching of which was the requirement to establish an effective system of governance. This built on the previous requirement for trustees to maintain adequate internal controls. Under these regulations, trustees are expected to have an effective system of governance that is proportionate to the size, nature, scale and complexity of their scheme. This system needs to include a documented risk assessment.

The majority of the requirements introduced by the regulations apply to schemes with 100 or more members. However, schemes with fewer than 100 members must still have an effective system of governance that is proportionate to their size, nature, scale and complexity of activities. TPR believes that trustees of schemes that are exempt from the requirements should, as good practice, meet its expectations wherever it is proportionate to do so.

TPR simplified a large number of its codes of practice and guidance when the General Code (general code)(code) laid before Parliament came into effect 28 March 2024. The general code replaced ten previous codes.

The Pensions Act 2024 (Codes of Practice) (Revocation) Order 2024

(3) This Order extends to England and Wales and Scotland.

Revocation of Codes of Practice

2. The following Codes of Practice are revoked with effect from 28th March 2024—

(a) the Pensions Regulator Code of Practice No. 1: Reporting breaches of the Law(2);

(b) the Pensions Regulator Code of Practice No. 4: Early leavers – reasonable periods(3);

(c) the Pensions Regulator Code of Practice No. 5: Reporting late payment of contributions to occupational money purchase schemes(4);

(d) the Pensions Regulator Code of Practice No. 6: Reporting late payment of contributions to personal pensions(5);

(e) the Pensions Regulator Code of Practice No. 7: Trustee knowledge and understanding (TKU)(6);

(f) the Pensions Regulator Code of Practice No. 8: Member-nominated Trustees and Directors – putting in place and implementing arrangements(7);

(g) the Pensions Regulator Code of Practice No. 9: Internal Controls(8);

(h) the Pensions Regulator Code of Practice No. 11: Dispute resolution – reasonable periods(9);

(i) the Pensions Regulator Code of Practice No. 7: Trustee knowledge and understanding (TKU): Second issue(10);

(j) the Pensions Regulator Code of Practice No. 5: Reporting late payment of contributions to occupational pension schemes: Second issue(11);

(k) the Pensions Regulator Code of Practice No. 6: Reporting late payment of contributions to personal pension schemes: Second issue(12);

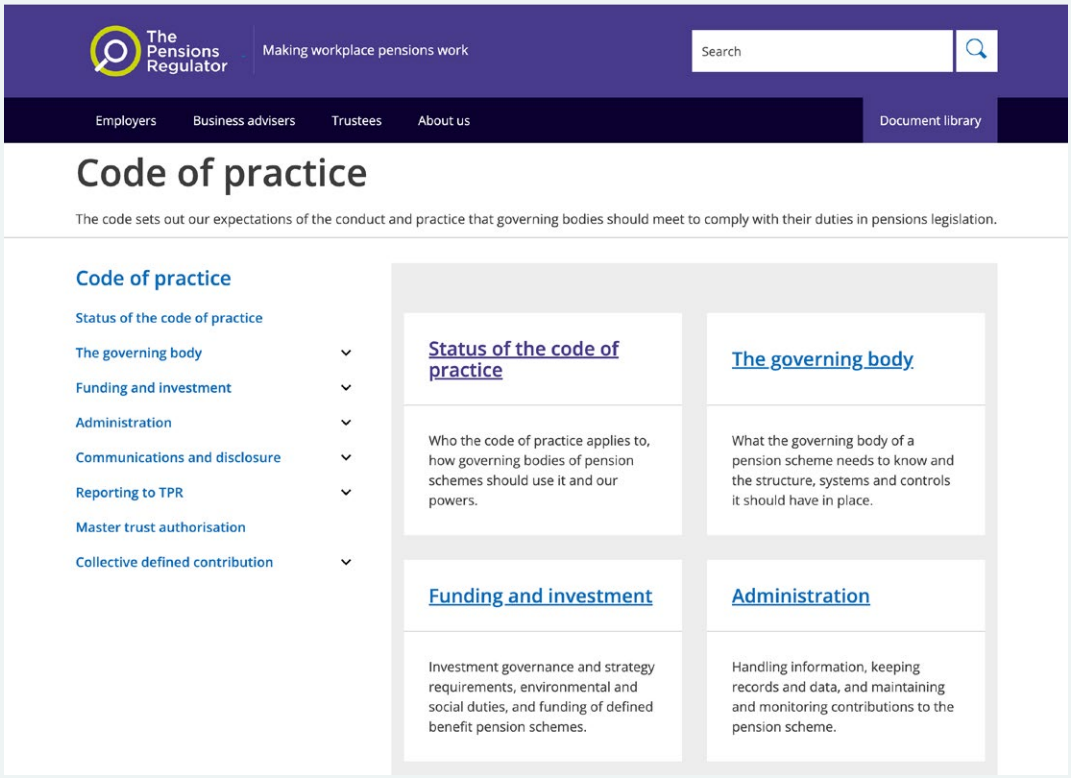
(l) the Pensions Regulator Code of Practice No. 14: Governance and administration of public service pension schemes(13);

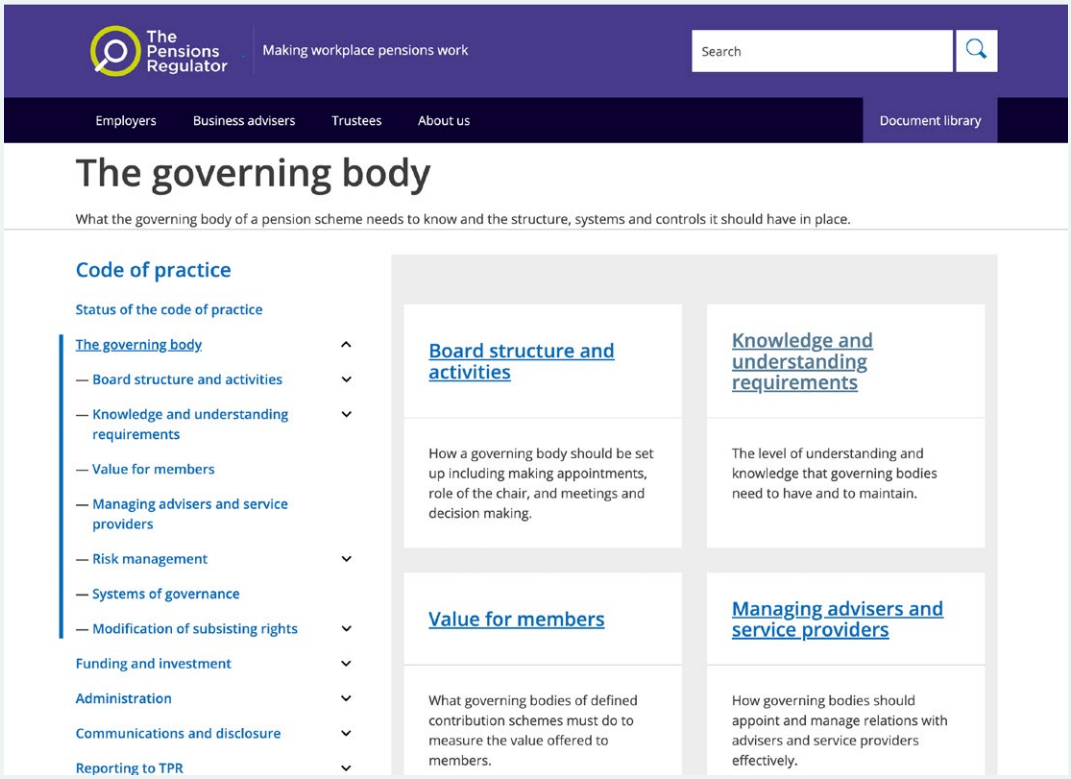
(m) the Pensions Regulator Code of Practice No. 13: Governance and administration of occupational trust-based schemes providing money purchase benefits(14).

Signed by authority of the Secretary of State for Work and Pensions

Jo Churchill

The comprehensive -170 page new code laid before Parliament has as its first main section 'The governing body' relating to Board structure and activities', 'Knowledge and understanding requirements', 'Value for scheme members', 'Advisers and service providers', 'Risk management', 'Scheme governance', together with other main sections 'Funding and investment', 'Administration', 'Communications and disclosure', and 'Reporting to TPR'. However, the intention is for the code not to be segmented into separate linear sections, but to embrace a governance thinking to consider all the aspects of law and good practice when carrying out pension duties that takes into account, for example when undertaking a transfer exercise, administration cyber controls and communication requirements as well as value for members and investment requirements. As a result, TPR's previously publications of codes and guidance are no longer available. TPR's website general code is found in the Code of practice section of the TPR Document library (**https://www.thepensionsregulator.gov.uk/en/document-library**) from which the various sections of the code are found under linked web pages and not as a standalone pdf with uniquely referenced paragraph numbers.




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Reporting to TPR
Board structure and activities
How a governing body should be set up including making appointments, role of the chair, and meetings and decision making.
Knowledge and understanding requirements
The level of understanding and knowledge that governing bodies need to have and to maintain.
Value for members
What governing bodies of defined contribution schemes must do to measure the value offered to members.
Managing advisers and service providers
How governing bodies should appoint and manage relations with advisers and service providers effectively.


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— Value for members
General code in force: 28 March 2024
This module forms part of our expectations for trustees of those schemes required to operate an effective system of governance, see Systems of governance.
1. The governing body is responsible for running a scheme. The governing body may be trustees or managers of an occupational pension scheme or, in a public service pension scheme, the scheme manager. Legislation may apply to each governing body differently, depending on the type of scheme they govern.
2. The governance of a public service pension scheme will need to take into account the differing responsibilities of the scheme manager, pension board and, where appropriate, pension committee. Each public service pension scheme should determine who fulfils the role of scheme manager according to their regulations and local arrangements. This code also sets out expectations for pension boards to help them assist the scheme manager. A pension board must have an equal number of employer and member representatives[1].
3. Those responsible for appointing members to the governing body should do so using the principles of proportionality, fairness, and transparency while also considering the mix of skills and experience needed by the governing body. As far as possible, the governing body should be well-balanced and diverse, with its members demonstrating varied skills, knowledge and experience. See also Recruitment and appointment to the governing body. The law also requires that members of certain governing bodies are fit and proper to carry out their duties[2].
4. In some cases, legislation may dictate how the governing body is made up, who can be a member and how members are appointed[3,4,5]. The governing body remains accountable for

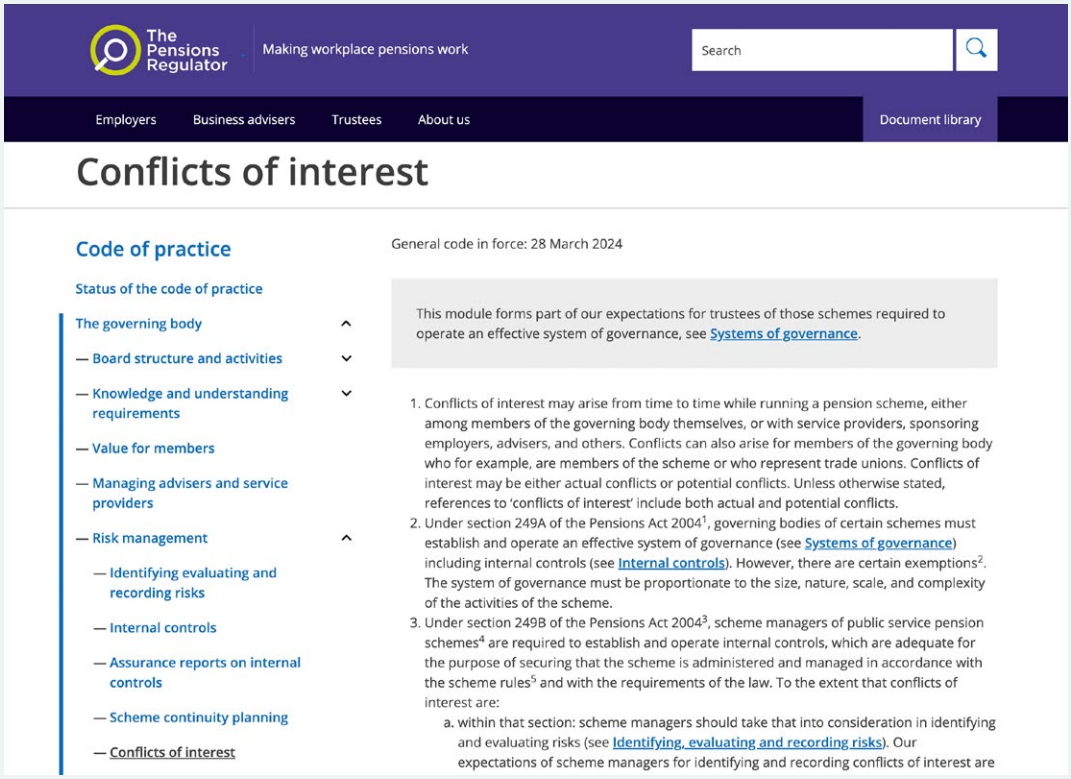
The key modules for which a student expected to know for this PMI governance manual unit are:

Scheme management detailed guidance

- Conflicts of interest (previously issued October 2008). This module forms part of the code expectations under the sections The governing body-Knowledge and understanding 13d. Risk management

  https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/the-governing-body/knowledge-and-understanding-requirements/knowledge-and-understanding

  https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/the-governing-body/risk-management/conflicts-of-interest

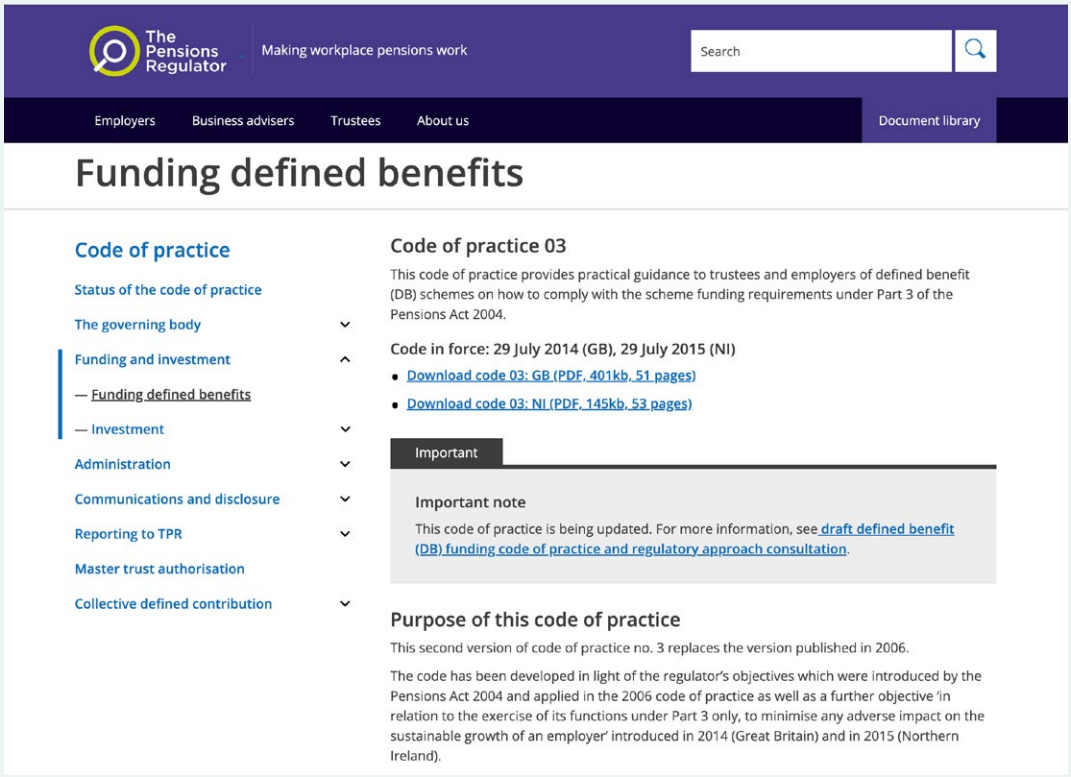


- Cyber controls. Last updated on 11th December 2023
  (previously 'Cyber security principles for pension schemes' issued April 2018)

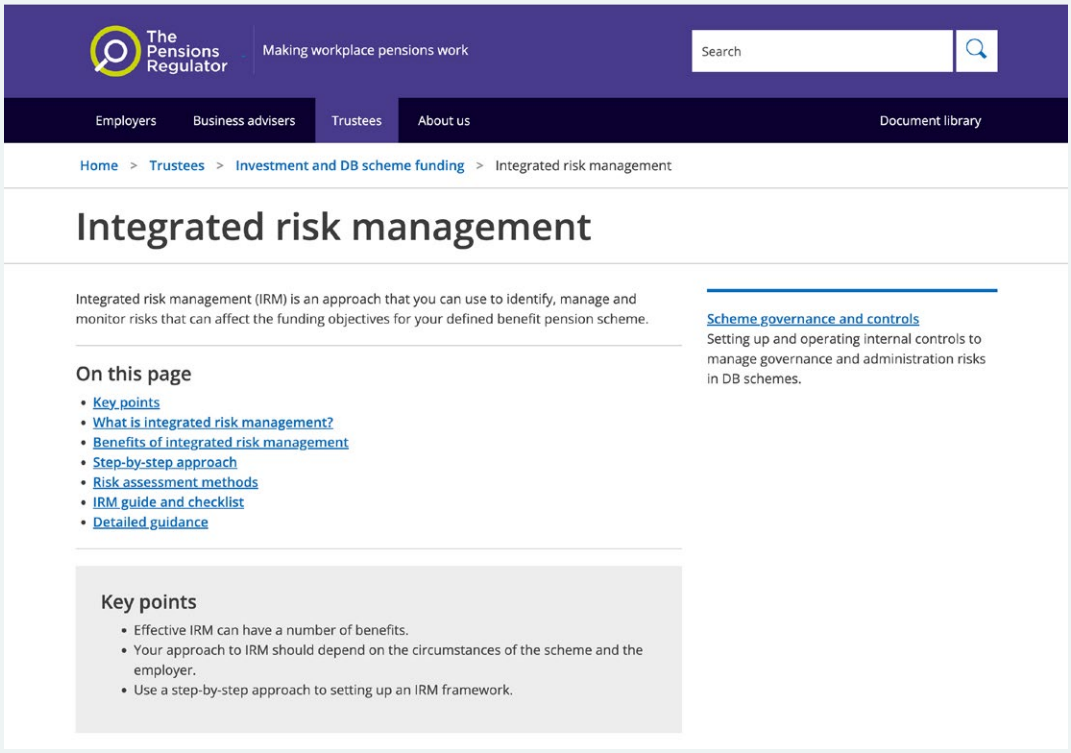
  https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/administration/it/cyber-controls

- Funding defined benefits (Code of practice no.3 still in force)

  https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/funding-and-investment/funding-defined-benefits



- Climate-related governance and reporting guidance (last updated September 2022 still in force)
  https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance/climate-related-governance-and-reporting
  and general code module 'climate change'
  https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/funding-and-investment/investment/climate-change
- Integrated risk management
  https://www.thepensionsregulator.gov.uk/en/trustees/investment-and-db-scheme-funding/integrated-risk-management



The general code of practice was issued by TPR under powers s90 and s90A of the Pensions Act 2004. Governing bodies (e.g. a board of trustees) need to be confident that they have a working knowledge of the pensions law relevant to them, and if not, it states in the words of TPR 'we urge them to consider whether they are meeting the requirements for knowledge and understanding, as they apply to them, and to undertake training as appropriate.' Governing bodies have to consider if they have a statutory duty under s70 of the Pensions Act 2004 to assess and report breaches of law.

The fundamental change created by the general code is the demonstration governance in action, where required, through the ESOG and the ORA.

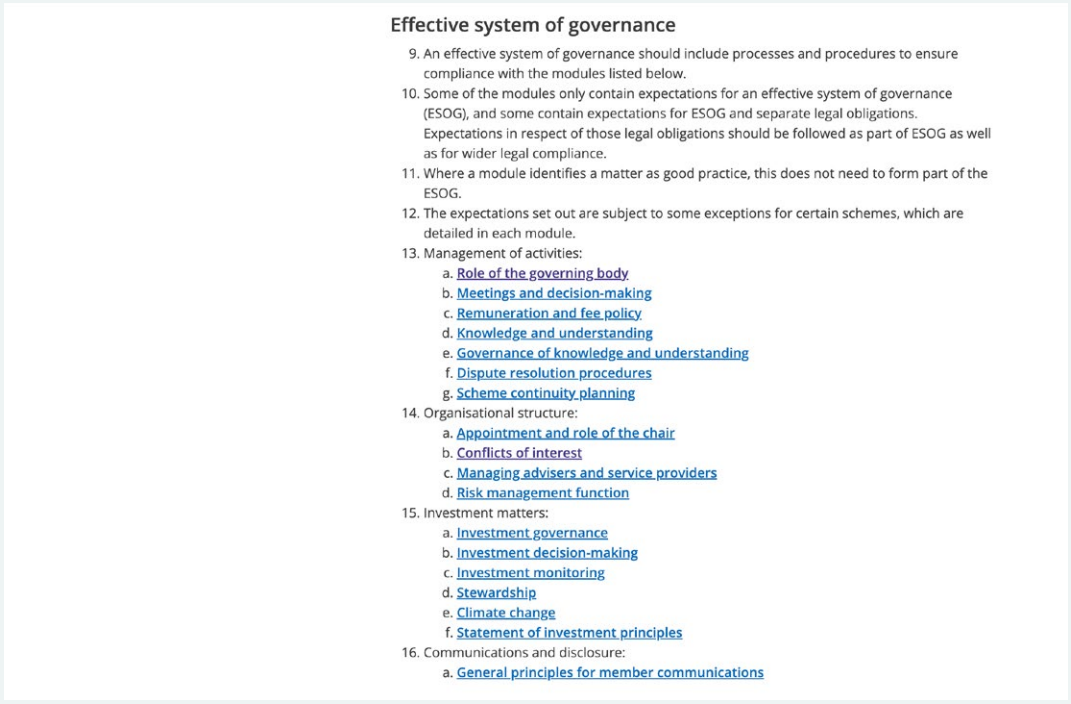
ESOG

The ESOG is the operation of an effective system of governance split into six different themes:

- Management of activities (including a new Remuneration and Fee Policy)
- Organisational structure (including a new risk management function)
- Investment matters
- Communications and disclosure
- Internal controls
- Administration and Management

The general code sets an expectation for governing body, organisational structure, investment matters and communications and disclosure. The ESOG established must be subject to regular internal review with each element of the ESOG reviewed at least every three years, or earlier depending on legal or code requirements. Different elements of the ESOG can be reviewed at different times either internally or through external assurance reporting. The first ORA should be completed, generally, within two scheme years following the date on which the code came into force on 28 March 2024. That means a scheme with a year end 31 March 2024 should have completed its first ORA by 31 March 2026.

https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/the-governing-body/systems-of-governance



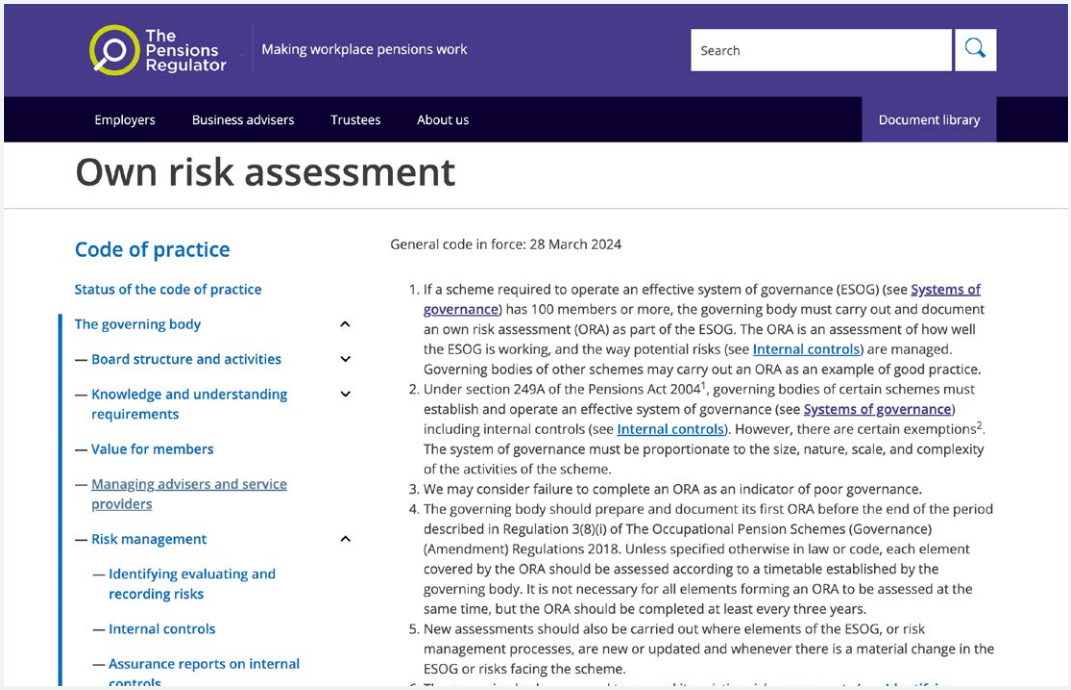
Effective system of governance

9. An effective system of governance should include processes and procedures to ensure compliance with the modules listed below.
10. Some of the modules only contain expectations for an effective system of governance (ESOG), and some contain expectations for ESOG and separate legal obligations. Expectations in respect of those legal obligations should be followed as part of ESOG as well as for wider legal compliance.
11. Where a module identifies a matter as good practice, this does not need to form part of the ESOG.
12. The expectations set out are subject to some exceptions for certain schemes, which are detailed in each module.
13. Management of activities:
    a. Role of the governing body
    b. Meetings and decision-making
    c. Remuneration and fee policy
    d. Knowledge and understanding
    e. Governance of knowledge and understanding
    f. Dispute resolution procedures
    g. Scheme continuity planning
14. Organisational structure:
    a. Appointment and role of the chair
    b. Conflicts of interest
    c. Managing advisers and service providers
    d. Risk management function
15. Investment matters:
    a. Investment governance
    b. Investment decision-making
    c. Investment monitoring
    d. Stewardship
    e. Climate change
    f. Statement of investment principles
16. Communications and disclosure:
    a. General principles for member communications

ORA

The ORA is an own risk assessment of how well the ESOG is working. The ORA is carried out by the governing body internally, risk management function or by a third party. It is required for schemes with over 100 members, although there are exceptions. The ORA is an internal document and must be signed off by the chair of the trustees. The ORA is not published and not submitted to TPR unless requested to do so. Trustees for good practice should decide on what parts of the ORA to communicate to members and in what detail.

https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/the-governing-body/risk-management/own-risk-assessment



Master trusts

Authorised master trusts are still subject to the code of practice 15 for ongoing supervision, whilst still required to follow the general code, there are no formal ESOG and ORA requirements.

1.2 TPR 21ST CENTURY TRUSTEESHIP AND GOVERNANCE

1.2.1 Raising The Standards Of Governance

The creation of the general code of practice that came into force in March 2024 was the completion of the work begun in raising the standards of governance stated as a key issue by TPR in 2016 in its discussion paper on 21st Century Trusteeship and governance reflecting guidance on companies issued by the Financial Reporting Council (FRC). To manage a scheme effectively with good decision-making TPR stated a scheme must have:

- Clear roles and responsibilities and clear strategic objectives
- A skilled, engaged and diverse board led by an effective chair
- Close relationships with employers, advisers and others involved in running the scheme
- Sound structures and processes focused on outcomes
- A robust risk management framework focused on key risks

1.2.2 Good Governance

Good governance is linked to good fund performance and good outcomes for members and needed motivated, knowledgeable and skilled trustees in place, roles and strategy. Good governance also needs the right structures and processes to enable effective, timely decisions and risk management with clear scheme objectives. Administration and record-keeping, DB funding and DC investment fund management (together with core transaction processing and costs and charges disclosure), and communication with members are essential areas to review.

The general code with the ESOG and ORA requirements has made this good governance to be formally documented, evaluated and signed-off by the chair of trustees (see 1.1).

1.2.3 Clear Purpose and Strategy – Trustee Business Plan

Clear roles and responsibilities allocation are essential for good governance. Trustees must focus on the strategic issues and delegate day-to-day activities and decision-making. The board should decide on the appropriate governance structure for its scheme according to scheme risk and complexity, what has to be decided at board level and what can be delegated to sub-committees and working groups.



Extract of allocation of roles and responsibilities pre general code (Source: TPR 21st Century Trusteeship)

Sponsoring employer			
Establish the scheme and appoint trustees			
Support the board by providing resources, time and training needed to govern the scheme well			
Pay contributions to the scheme			
Collaborate with the board by providing views and discussing risk where schemes fund defined benefits			
Trustee board			
Roles allocated	Chair of trustees	Professional trustee	Trustee
Lead and support the board	**Y**		
Ensure collective competence of the board with appropriate governance processes in place.	**Y**		
Make sure meetings and scheme business are run efficiently with trustees, advisers and service providers who participate effectively.	**Y**		
Provide professional expertise and ensure good governance.	**Y**	**Y**	
Run the scheme in the best interests of all members including deferred members, pensioners and other beneficiaries in accordance with the scheme documentation.	**Y**	**Y**	**Y**
Develop and maintain effective governance and internal controls to deliver investment (and funding for defined benefits), administration and communication activities.	**Y**	**Y**	**Y**
Decide what help to get and what to delegate.	**Y**	**Y**	**Y**
As a trustee board, make decisions and set the scheme's objectives and strategy.	**Y**	**Y**	**Y**
Effectively monitor and oversee advisers and those carrying out scheme activities.	**Y**	**Y**	**Y**
Foster an open and constructive relationship with employers to understand their views and risks.	**Y**	**Y**	**Y**
Adviser (investment consultant, actuary, covenant adviser, lawyer)			
Provide clear and relevant advice focused on areas that have the most impact for schemes. This includes scheme strategy, performance and governance, and helping trustees to comply with legal and regulatory requirements.`			
Help trustees to run schemes effectively, offering feedback and challenge.			
Co-operate with other advisers			
Service provider (administrator, fund manager, software provider)``			
Professionally deliver day-to-day business and operations for the scheme either as a third party or in-house.			
Scheme manager/ secretary			
Work with the trustee board to make sure the scheme is efficiently and properly run, members' benefits are secure and oversee day-to-day activities (manager) or support efficient and effective governance (secretary).			

Trustees range from individuals volunteering as a member of the scheme with little knowledge to highly experienced professional trustees who chair more than one scheme.

Types of trustee are:

- **Individual trustee** as one of several trustees responsible for running the scheme. This group is often referred to as a board of trustees. (See Part 1 1.4.1 for more details).
- **Corporate trustee** where the trustee is a company and a director of that company with the same responsibilities as an individual trustee in relation to the scheme. The employer itself may be the corporate trustee.
- **Member-nominated trustees (MNTs) or member-nominated directors (MNDs)** – some individual trustees, or directors of a trustee company, may be nominated to be trustees.
- **Employer-nominated trustees (ENTs) or employer-nominated directors (ENDs)** - may include senior employees like the finance director, where their financial experience and knowledge of the company may be helpful to the trustees or the directors of the trustee company.
- **Professional trustees** – someone will normally be considered a professional trustee if they have represented themselves to one or more unrelated schemes as having expertise in trustee matters generally. Professional trustees are likely to be given higher penalties under the penalties policy. A professional trustee is now increasingly being required to be an accredited trustee through the PMI or the Association of Professional Pension Trustees (APPT) Accreditation scheme. Each of these accreditations include passing units 1 and 2 of the PMI Level 3 Certificate in Pension Trusteeship, and a demonstration of pension experience. There is also a new standalone PMI Diploma in Pension Trusteeship designed to show judgement when dealing with complex pension issues and which also integrates ESG into its course material. A professional trustee firm may offer a sole trustee service. (See Part 1 1.4.1 for more details).
- **Chair of trustees** – in most schemes with defined contributions, the chair of trustees has the additional responsibility of signing the annual chair's statement, indicating that the scheme is operating in line with the required governance standards. A chair of trustees also should ensure that trustee disclosure requirements are met on investment governance through a published online scheme implementation statement along with the scheme Statement of Investment Principles (SIP), and the scheme's own risk assessment is signed-off within the three year or earlier deadline (see 1.1).

1.2.4 Clear Purpose And Strategy

Trustees are expected to have a clear strategy for the scheme which sets out what the board does, how to manage the scheme effectively and how to get good outcomes for members. Trustees should review this business plan regularly. The scheme's business plan should cover:

- Clear, long-term goals for your scheme and interim objectives around key areas of focus including governance, investments (and funding for defined benefit schemes), administration and communications.
- how the trustees propose to meet the scheme objectives and goals.
- how the trustees will measure and monitor progress towards them.



The business plan (or trustee governance business plan) would cover a period of one to three years with set strategic objectives. The governance objectives for these involve:

- Governance e.g. establishing a governance structure to achieve long term goals, managing training and development of trustees and board evaluation.
- Compliance, e.g. processes and tools in place to ensure compliance with legal and code Requirements.
- Funding, e.g. developing a flight plan, negotiating contributions with the scheme sponsor.
- Investment and risk, e.g. putting in place an integrated risk management process.
- Sponsor relationship, e.g. arrangements in place to maintain an effective relationship with the scheme sponsor.
- Member experience and engagement, e.g. establishing a communication and member engagement plan to support feedback on value for members costs, create an annual budget, understand and document full running costs of the scheme.

Many schemes will require a more detailed annual planner (or resource annual planner) that is set out in a document under activity titles to log tactical events that help carry out the strategy:

- Trustees' meetings
- Governance and compliance
- Annual report and accounts
- Actuarial
- Investment
- Administration
- Communication

As an example of these tactical events, the governance and compliance tasks in the annual planner would involve preparing the annual chair's statement, SIP, implementation statement, reviewing the risk register and associated tasks, submitting returns to TPR and HMRC, data protection registration renewal, trustee knowledge and understanding tasks, and reviewing training plans.

The key checks on governance that a trustee board needs to ask itself are:

- 'Does our scheme have a business plan that includes strategic goals and interim objectives?'
- 'Do we monitor progress against the objectives in our scheme business plan?'
- 'Do we review our scheme's business plan and objectives regularly?'

1.2.5 Value For Members

Trustees must monitor and record the value for members the scheme is achieving so they can make informed decisions on behalf of its members and help safeguard positive member outcomes. Trustees of DC schemes have a legal duty to produce a Value for Members (VFM) assessment and include findings in their annual Chair statement. TPR also strongly recommended that DB schemes assess value for members even though this is not a legal duty.

Regulations require DC trustees with less than £100 million of assets under management to compare their scheme's costs, charges and investment returns against three other larger schemes. They must also carry out an assessment of their scheme's governance and administration in line with seven key metrics. Scheme must carry out this detailed VFM assessment at every scheme year end after 31 December 2021. The outcome of this assessment must be reported in their annual chair's statement and the findings provided to TPR in their scheme return.

There is no 'boiler plate' for VFM assessment as the range of services, benefits and membership vary significantly from one scheme to the next. TPR expect a proportionate approach and framework is established that can be repeated and improved upon each year. Simple steps that trustees should follow are:

- Gathering information on all costs and charges in a timely manner to ensure the assessment is completed by the statutory deadline.
- Considering whether the benefits and services received in exchange are of good quality and meeting the needs of the membership.

Trustees should consider at a minimum the following key areas:

- Scheme management and governance
- Administration
- Investment governance
- Communications
- Comparing these costs and charges to other options on the market
- Reaching a conclusion and agreeing next steps (i.e. any actions required to address poor value), documenting the approach taken and to be used as evidence of the assessment
- Reporting on the outcome of the assessment in the annual Chair's statement (if applicable)

Value for members is a key component of the Chair's statement. It is a requirement that any particular member-borne costs and charges that do not represent good value is stated with the action the trustee have taken, or plan to take, as a result.

Steps given in the Value for members guide are:

step 1: gather information on what the scheme provides for members and at what cost across the four core areas of scheme governance and management, investment, administration and communications. What members receive for what they pay in these four core areas.

step 2: assess the scope and quality of scheme services to members. The key questions are

- Member need: Are the benefits provided by the scheme's services suitable for, relevant to and valued by members?
- Performance: have the scheme's services to members performed effectively over the past year and do you believe they will continue to perform effectively?

step 3: evaluate the scope and quality against the costs.

step 4: report on the outcomes and take action to address poor value. Actions advised are: remove unused services, re-tender for services, simplify or standardise particular services, obtain a scale-related discount to reflect an increase in the scheme's size, membership or assets, reduce a particular charge and challenge the relevant service provider directly.

In addition to the full review at least once a year, ongoing monitoring and evaluation is advised to be built in between the annual time period should there be any developments. This could include any changes in legislation or regulations, number of both new members and members who have left the employer and/ or stopped contributions, whether the scheme has switched between products or changed investment platform, whether new risks have emerged, whether new technology has become available on the market which could influence the relative competitiveness and sustainability of certain service providers, and the level of and reasons for member complaints.

Value for members is part of the general code within the section 'The governing body'.

https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/the-governing-body/value-for-members

1.2.6 Trustee Training, Skills And Advisers

Trustee must have the knowledge and understanding to perform their role within six months of appointment. A professional trustee must have relevant knowledge and understanding when appointed. All trustees are expected to identify strengths, weaknesses and any gaps in knowledge and understanding by carrying out self-evaluations and board evaluations. Training should be based on these and trustee training plans linked with the scheme's business plan.

TPR have stated that skills and experience are improved with there is a diverse board helping to manage the scheme, and should be an area of focus when recruiting and selecting trustees. Working well with good quality professional advisers and service to provide advice and manage certain aspects of a pension scheme is stressed as a vital part of governance by TPR. Trustees should retain sufficient oversight of the tasks they delegated to others and regularly review and manage their performance.

1.2.7 Risk And Conflicts Of Interest That Pension Schemes Face

There has to be a plan to identify, document, evaluate and manage risks for every pension scheme. This will require a risk register to be reviewed and updated regularly for the effect effectiveness of controls to take account of new and emerging risks, and a change in status of current risks.

Risk registers are a key governance tool for trustees and should cover:

- the way the scheme is governed and managed
- the scheme's investments
- administration processes (including as pension scams and cyber security threats.
- the way the scheme communicates and engages with members

TPR has repeatedly stated that a scheme is legally required to have adequate internal controls in place in your scheme, and this includes managing risk. This means documenting the scheme's internal controls, using an agreed evaluation process to rate risks based on their magnitude (likelihood of happening against impact), and **taking steps to manage or mitigate them**. These are recorded as identified risks and mitigating controls in a risk register and reviewed regularly. Processes are also required to continually review exposure to new and emerging risks including significant changes in, or affecting, a scheme and its membership. More details are given in the manual 2.2 Risk Register.

Risk appetite is the amount and type of risk that the pension scheme is willing to take in order to meet its strategic objectives. Risk tolerance is the amount of risk that a pension scheme can feasibly cope with.

Trustees should carry out a detailed analysis of their risk management framework at least annually to identify whether your existing systems are still fit for purpose. For example, do they prevent and detect errors in the scheme existing scheme operations, and will they help mitigate new risks?

For DC schemes key risks and issues must be reported on the Chair's statement and published on a website to be made available to members in the scheme annual report and accounts. Each pension scheme will have its own risks. Whether the scheme is DB or DC the risks that trustees must consider can be broken down into the five broad categories outlined below. The following lists are examples of some of the risks that trustees face, but these lists are not intended to be exhaustive. For instance, master trusts that provide money purchase benefits will have specific additional risks such as regulatory reporting and funding obligations to comply with the authorisation criteria of the Pension Schemes Act 2017.

1.2.7.1 Operational

- Weakness in administration processes
- Incomplete investment holdings
- Incorrect payment of benefits
- Inadequate record keeping
- Failure to regularly reconcile unit holdings on the administration system with those of the investment manager
- Failure to calculate benefits correctly

1.2.7.2 Financial

- Misappropriation of assets (theft or fraud)
- Incorrect contributions paid by the employer
- Late payment of contributions to investment provider
- Contributions going astray, i.e. the payment process is not secure
- Late receipt or non-receipt of contributions
- Ineffective cost control
- Inadequate focus on investment options, or inadequate explanation to members of financial decisions (DC Schemes)

1.2.7.3 Funding (DB schemes)

- Inadequate investment performance
- Ignorance of Codes of Practice (e.g. Investment Decision Making)
- Failure to maintain proper documentation (e.g. Statement of Investment Principles, Schedule of Contributions)
- Mismatch between assets and liabilities
- Failure to identify liabilities correctly
- Inappropriate actuarial valuation assumptions
- Failure to understand financial position of scheme
- Failure to keep Statement of Funding Principles maintained

1.2.7.4 Regulatory

- The appropriate procedures for trustee appointments are not followed, or the required number of Member Nominated Trustees is not in place
- Breach of legislation
- Failure to appoint a Scheme Administrator
- Failure to report notifiable events
- Failure of a DC scheme to comply with good governance standards

1.2.7.5 Compliance

- Acting outside the powers of the Trust Deed
- Failure to comply with the provisions of the Trust Deed and Rules
- Failure to regularly review investment manager performance
- Failure to comply with anti-money laundering rules
- Failure to adopt and implement an effective policy on conflicts of interest or duty (including an anti-bribery policy)

1.2.7.6 Covenant Guidance

This was effective for valuations from 22 September 2024. There were new Requirements that Trustees must formulate a funding and investment strategy incorporating covenant assessment. A Covenant was defined as an employer's financial ability, future cash flow projections, business resilience, and insolvency risk.

1.2.7.7 TPR Guidance

This covers

- Employer Identification. It focuses on legal sponsors and potentially multiple employers.
- It also involves cash flow, to evaluate operational cash flow after deducting essential costs.
- Employer Prospects: Include ESG, market position, and group structure.
- Longevity & Reliability: Typically 3–6 years for reliability; less than 10 years for support longevity.
- Contingent Assets: Must be legally enforceable and assessed by type.
- Recovery Plan: Contributions should be prioritized as schemes mature.
- Supportable Risk: Based on employer affordability and covenant strength.
- Monitoring: Annual monitoring recommended..

1.3 REVIEWING AND MANAGING RISKS

Although many different people and organisations are involved in the running of a pension scheme, ultimately the responsibility for reviewing and managing risks lies with the trustees. It is the trustees who have legal responsibility for operating the scheme, and who risk facing legal liability if any errors are made. Similarly, it is the trustees who will face difficult questions from scheme members, the sponsoring employer and perhaps TPR if the scheme is not run properly.

So, even though most trustees will delegate many of their functions and receive detailed support from their advisers and providers (1.4 below), trustees need to have a good grasp of all the different aspects of scheme management. In facing this challenge, it is important for trustees to understand which areas of the scheme's operation carry the most significant risks, and in which areas more work is needed to reduce risk.

Experience shows that it is not normally possible to eliminate risk. Particularly for something as complex as a pension scheme, there is always a danger that some kind of complication or difficulty could come up unexpectedly, whatever efforts the trustees and others may have made. In particular, a pension scheme operates over very long time periods, and it is quite common that an error or problem can come to light many years after the act that caused it – for example because an error in benefit calculations lies undetected until members reach retirement many years later, or because a decision to make a particular investment only proves unsound with the benefit of hindsight. So trustees must do all they can to reduce risk as far as possible, but they will need to accept that there will be times when mistakes happen, and the task they face then is to decide how to handle the resulting difficulties.

The important practical result of this is that, when assessing all the different risks faced by a pension scheme, trustees need to be proportionate. A particular danger is that trustees might focus too much energy in trying to eliminate risk in one area, while not spending enough time on others, and this is likely to be counter-productive.

When deciding their strategy for reviewing and managing risks, therefore, trustees should focus on two main points:

- Identify the risks that the scheme faces, and what they can do to limit those risks.
- Understand what the worst case scenario is in each area, and what the implications would be for the scheme if the worst happened – and what kind of fire-fighting action the trustees would then need to take. By focusing on this, in conjunction with the first point, the trustees can understand the level of risk in each area. This will show whether the scheme faces its biggest risks in, for example, the area of administration, funding, employer covenant etc.

By taking these two steps, trustees can get a rough idea of how much time and energy they should be spending monitoring different areas of the scheme's operation, and which are highest priority, in other words which areas need attention sooner than others.

Whatever stage a scheme is at in its life cycle, and whatever the strengths and weaknesses of the scheme's operation, the trustees will always find themselves needing to juggle the different types of risk. So, their success in operating the scheme will depend on how well they manage this juggling exercise.

They should seek to ensure that adequate protections and controls are in place in each area, but without more bureaucracy than is needed – because it will be hard to operate a scheme properly if the time spent on bureaucracy starts eating into the time spent actually dealing with risks.

1.3.1 Risks From Conflict Of Interest

The TPR has emphasised the need for the trustee board to have a conflicts of interest policy and processes in place to help identify, manage or avoid conflicts for trustees, employers, advisers and service providers. Approaches to adviser conflicts of interest should be in the trustee conflicts policy, risk register or in other documented procedures. The conflicts of interest policy should be reviewed by a legal adviser from time to time, to pick up scheme-specific issues.

1.3.2 New And Emerging Risks – Low Carbon Economy, and Pension Scams

A trustee board could consider that with climate change and a drive for development in a low carbon economy there was a material risk that the investment strategy to deliver a required level of return over the long term would not be realised with the current investment plan. When reviewing the statement of investment principles (SIP), a trustee board could consider market developments and concluded that climate risk is financially material to the investment strategy, and set out the following investment belief: 'As long- term investors, we believe climate risk has the potential to significantly affect the value of our investments.' This belief could be expressed in the SIP as follows: 'We expect fund managers to have integrated climate risk into their risk analysis and investment process.'. In monitoring the performance of its scheme fund managers, the trustee board would regularly consider how they are performing with reference to climate risk issues. In addition, the trustees could decide to report annually to members on how the scheme's climate risk policy had been applied.

More than £17.5 million was lost to pension fraud in 2024. Number of reported cases was 519 with an average loss pre victim of £33,848 equivalent to £48,000 lost every day across the year. The flexible withdrawal of pension pots since 2015 has increased the risks of pension scamming.

To help trustees and advisors manage new and emerging risks information can be found at TPR's media hub (**www.thepensionsregulator.gov.uk/media-hub**). Recent information published include:

- The Pensions Regulator uses anti-avoidance powers to protect the plumbing industry pension scheme published on 28th July 2026
- TPR strengthens supervision and standards in a changing pensions system – Annual Report and Accounts 2025/26 on 30th June 2026
- TPR publishes new five-year Corporate Strategy, detailed Corporate Plan and Regulatory Roadmap 14th July 2026

Other sources for alerts on new risks and new approaches to deal with existing come from professional institutes and firms blog and knowledge pages (**https://www.pensions-pmi.org.uk/knowledge**). This Pensions PMI Knowledge section also has a 'Reports and guides' sub-section.

1.4 THE ROLE OF ADVISERS AND PROVIDERS

1.4.1 Deciding Which Providers To Use

For most pension schemes of any size, the only way that trustees can manage risks successfully is to draw on the experience and effort of others outside the trustee group. This is partly because many trustees are lay people whose day job does not involve working with pensions – and also because a complex operation such as a pension scheme can only run well if certain tasks are delegated, giving an efficient division of labour.

The amount of support that trustees receive from others will vary, depending mainly on the size of the scheme. That said, for any pension scheme, however simple or complicated and whatever its size, it is important that the individuals serving as trustees have confidence and trust in the advisers and providers they use, and the systems under which support is provided.

Trustees are expected to be familiar with and understand the impact of the terms and conditions of contracts with service providers. This includes (and is not limited to): the scope of services being provided, the cost of those services and the basis for calculating those costs, arrangements for penalty fees for service provision change and limitations on liability.

The advisers and providers (and also described in Part 1 1.2.2) involved in running a pension scheme will generally include the following:

- **Independent trustee/sole trustee** – the independent trustee will serve as one member of a larger Trustee firm or as a sole trustee – either because the scheme is in winding- up or because the employer has decided that this is a better governance model than having a larger trustee board. In many cases the independent trustee will be a professional trustee (either a company or an individual), or at least will have built up a strong knowledge of pensions, perhaps from having served as a trustee for a long time. Independent trustees, particularly those with expert knowledge, can be extremely valuable in helping a scheme to run efficiently and minimise risks. Typically, the power to appoint an Independent Trustee lies with the scheme's sponsoring company, rather than with the other trustees.

The independent trustee will often act as the chair of the trustee board with the task to provide effective leadership, demonstrate decision-making skills at meetings, and encourage open and constructive debate, and encourage that each trustee should arrive fully briefed on the agenda and prepared to discuss each item. TPR have emphasised that the professional trustees should realise how their planning and behaviour can contribute to effective trustee meetings with their own policy on managing conflicts of interest, assisting trustees with carrying out actions arising from previous meetings, timely and informative investment performance and strategy reports, highlighting risks to the scheme, administration reports, areas for improved member engagement, fees and budget monitoring, trustee training and meeting targets for the business plan.

The PMI Certificate in Pension Trusteeship Unit 2 picks up on many of these 'soft skills' requirements.

A sole trustee can be a professional trustee firm with employees, a franchise model for smaller operators under the name of an umbrella organisation or an independent sole trader. TPR has expressed concerns its over sole trusteeship because of its potential for ineffective conflicts of interest and poor saver engagement. However, in its closed consultation February 2020 Future of trusteeship and governance TPR stated that it did not propose to make changes to the way the current regulated sole trusteeship model, and would continue to keenly scrutinise schemes that used a sole trustee.

Sole trustee governance requirements are being toughened. Though the APPT's code of practice on Professional Corporate Sole Trustees (PCSTs) came into force on 1 January 2021 stated, amongst other things, that a PCST should not be a sole trader (**https://appt.org.uk/appt-cop-for-sole-trusteeships-final**) .

- **pensions manager** – a pensions manager is normally an employee of the pension scheme's sponsoring company, whose job includes assisting the scheme's trustees. It is the company's decision whether or not to have someone serving in the pensions manager role. Some companies outsource the pensions manager role, in effect, by asking one of their third-party providers to carry out elements of the role (for example the Secretariat or Pensions Trustee Secretary function mentioned below).
- **pensions trustee secretary**– all trustee boards need a scheme secretary, in the sense of someone who has responsibility for taking minutes of trustee meetings, and needs to make sure the milestones, timelines and events set out in the scheme business plan are carried out . But there is a difference between this and the wider secretariat role, which is very important in the smooth running of a pension scheme, particularly a scheme of any size. The Secretariat role involves a wide range of tasks, of which the main ones can include: organising meetings; making sure that meeting agendas are set properly, and that meetings run to time; anticipating the need for advisers to give input on particular topics; chasing the advisers to give their advice on time; taking the lead in making sure that projects are driven forward in the periods between trustee meetings; co-ordinating the trustees' response to any difficulties that the scheme might face,
for example complaints from members; and a high number of other miscellaneous tasks that are delegated by the trustees. The role will often be carried out by the scheme's pension consultants, or sometimes by employees of the scheme's professional Independent Trustee. There are also some niche companies which have set up specifically to perform the secretariat function for a number of schemes. The effectiveness of the person in the secretariat role can have a strong bearing on how well a scheme is operated, and on how well the scheme recognises and handles its risks – in particular because an effective secretariat can make sure that necessary action is being taken throughout the year to address potential risks, rather than being bunched up around the three or four regular trustee meetings.
- **scheme auditors** – every occupational pension scheme must have independent auditors under section 47 of the Pensions Act 1995. The scheme's auditors will carry out a regular annual audit, in the same way that auditors do for companies. The annual audit is not designed to expose all errors in the running of the scheme, but it provides a useful incentive for trustees to make sure the scheme is operated properly. Separately from the annual audit, some schemes have used auditors in helping them to put together a risk framework; and defining the risk management process. Alternatively, trustees might be able to make use of the sponsoring employer's internal audit function.
- **specialist advisers** – most pension schemes of any size will have several different advisers, or perhaps one or two advisers which serve several different roles. The most common are investment advisers; a scheme actuary (a necessity for a DB scheme); legal advisers; and, for a DB scheme, possibly an external covenant adviser. Most trustee boards also have an adviser who serves as a general pensions consultant, and often it will be one of the advisers mentioned above who doubles up in this role (for example the scheme

actuary), or another employee of the same advisory company.

- **administrators and other providers** – a fundamental role is played by various other parties, including the scheme's administrators, actuary, investment managers, custodian and (if the scheme is insured) the insurance provider. Trustees expectations of these providers and level of proactivity, will vary on the type of scheme, its business plan and the trustee board in the way they interact with the trustees, and the scheme's risk management processes.

When trustees start setting up a procedure for reviewing and managing risks, or when they come to update their existing procedure, most of those listed above will have a role to play. Given the importance of ensuring the scheme's risk procedures work effectively, it is almost always worthwhile involving the various advisers closely in discussions about how the risk management process should work, and confirming their roles, and timetable for delivering their work.

1.4.2 Systems For Reviewing Providers And Regulator Expectations

A regular assessment is required of each service provider against targets, measures and documented objectives. Poor performance is expected to be challenged, and service contracts are expected to have pathways for complaint and performance management issues to be followed. In-house providers are also expected to have a similar scrutiny by trustees.

A typical structure for review of providers might involve a rolling programme, for example over three years, and more recently an ongoing rolling 'scoring' process for selected service providers. Each of the providers will be due for review at some point during that time period. At that stage the trustees could either discuss the provider's appointment in a closed meeting, or they could complete a questionnaire, perhaps giving the providers scores under various headings (value for money, standard of advice, communication etc.) and any further comments that they wish to make. If the provider falls below a certain score, or if the discussion or the questionnaire reveals that the trustees have concerns about the provider's service, then the next step might be for the chairman or secretary to discuss this with the provider and agree what steps to take.
If the trustees have certain concerns about the provider's performance but feel that these can be addressed, the provider might be given a certain time to improve and deal with these concerns, perhaps six months or a year. If the trustees' review reveals more serious concerns, or if the provider fails to make the improvements requested, then the trustees could move on to a reselection process.

Different review processes are likely to be appropriate for schemes of different sizes. As well as a formal structure of the type outlined above, a very large scheme is more likely to have additional advisers on standby to give a second opinion in certain cases, or sometimes "shadow" the advice been given by the primary providers.

In the general code The governing body section 'Managing advisers and service providers' states that policies regarding outsourcing should be reviewed at least once every three years, and appointments and established agreed and documented policies for appointment should be in place before commencing any procurement process, and set out expectations of service providers degree of delegation, conflicts of interest management, internal controls, assurance reports, performance KPI and SLA setting and review of performance, and assessment of avoiding member detriment should the service providers fail in their duties.

(**https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/the-governing-body/managing-advisers-and-service-providers**)

TPRs master trust Guide to completing the systems and processes questionnaire (October 2018) stated that key service providers were: scheme administration, adviser consultants, IT software and services, investment management and member communications. Some of these should have detailed criteria for assessment, key performance indicators and service level agreements. Trustees were expected to demonstrate they understood and were familiar with the contracts/ agreements (and any impacts on service/ability to act) in place with all service providers to the master trust.

The TPR statement Managing service providers February 2018 summarised expectations of good practice by trustees and scheme managers on the management of service providers, and planning for events which could have major consequences for their schemes, including the failure of service providers.

The TPR statement about managing service providers from February 2018 has now been replaced.

The relevant content is now found in the TPR Single Code of Practice, particularly within:

1. The Governance and Reporting of Trustees (G&RT) module

Covers:

- oversight of outsourced functions
- accountability for delegated activities
- monitoring and review of service providers
- contract management expectations
- business continuity and contingency planning

2. The "Managing service providers" expectations are now embedded across these Single Code modules:

- ***Risk Management*** – requirement for an effective risk management function, including risks arising from third-party providers.
- ***Outsourcing and Delegation*** – trustees remain accountable; must ensure competence, performance monitoring, and clear contractual terms.
- ***Business Continuity and Disaster Recovery*** – schemes must have a BCP and understand providers' BCPs.
- ***Records and Data Management*** – requirements for data handover, security, and continuity if a provider fails.
- ***Investment Governance*** – where investment services are outsourced, trustees must ensure appropriate oversight and reporting.

These modules collectively replace the standalone 2018 statement.

What the Single Code now requires (mapped to the old 2018 expectations)

A. Reviewing and appointing service providers

- Consider multiple providers.
- Assess skills, experience, training, and regulatory compliance.
- Use independent frameworks (e.g., ISO standards) where relevant.

B. Contractual understanding and control

Trustees must understand:

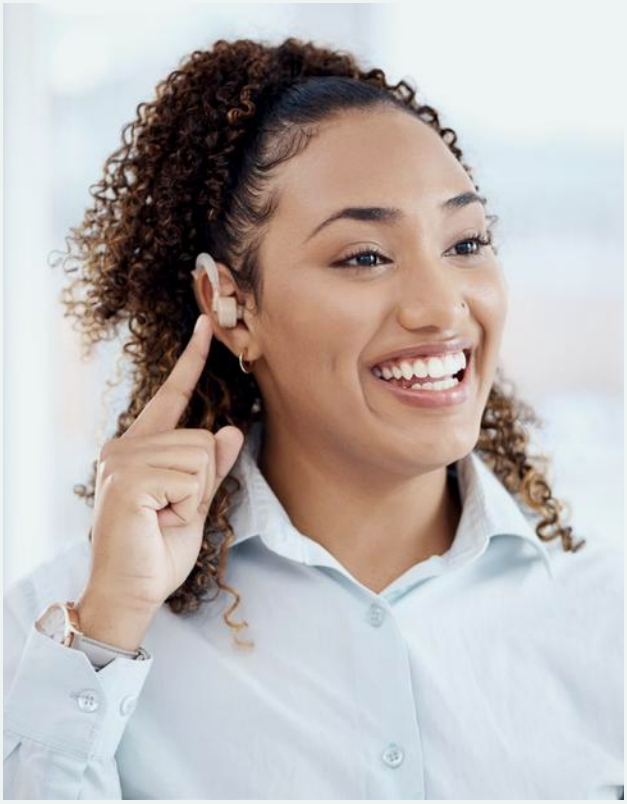
- scope of services
- costs and charging structures
- liability limits
- termination provisions
- handover obligations

C. Ongoing monitoring and performance management

- Use SLAs and KPIs.
- Require regular reporting.
- Address poor performance promptly.

D. Continuity and provider failure planning

- Maintain a documented procedures manual.
- Have a business continuity plan (BCP).
- Understand the provider's own BCP.



1.5 DE-RISKING FOR DEFINED BENEFIT (DB) SCHEMES

1.5.1 Dealing With Funding Risk

For DB schemes, as opposed to DC schemes, there is an extra element in the risk management process concerning funding. Trustees of a DB scheme must focus their attention not only on avoiding mistakes in the way the scheme is run, but also catering for the risk that the sponsoring company might not be able to support the funding of the scheme at some point in the future.

The ability of a company to support the funding of its DB pension scheme is often known as the employer's "covenant". A company may be regarded as having a strong covenant, or a weak covenant, or somewhere in between. Accordingly, this area of risk is often referred to as 'funding risk' or 'covenant risk'.

When considering this risk, DB trustees should always be conscious that, generally speaking, there are only two ways of making sure the scheme's members will receive their benefits in full, as well as a new DB 'superfund' option:

1. **Buy-out the scheme benefits in full with an insurance company**, or Buy-in a partial amount of the scheme benefits with an insurance policy paying a proportion of members' benefits such as pensioner payroll. Since pension schemes began to face difficulties with funding deficits, only a small number of schemes have succeeded in buying out their benefits fully. However, it is an increasingly desired option for many. For most schemes, the cost of buying out benefits with an insurance company is much greater than the assets currently held in the scheme – meaning that there is a 'buy-out deficit'. If so, there are only two ways that a buy-out could be viable. The first is for the employer to pay a large lump sum to the scheme to enable it to buy out – which a handful of companies may be willing to do, since it removes the volatile pension liabilities from the company's balance sheet. The second possibility is for the trustees to improve the scheme's funding level gradually over time, to the point where the deficit is small enough for a buy-out to be considered, with the company topping up the funding at that stage.
2. **the sponsoring company remains strong enough to support the funding of the scheme.** For the majority of DB pension schemes, where the company is not willing or able to pay the buy-out deficit. For schemes in this category, the trustees' risk assessment involves looking at two main things:
   - The scheme's funding level – assessing the funding level is a complex exercise which involves detailed actuarial advice, and also takes into account the way the scheme's assets are invested (see below). Pensions legislation contains complex requirements that trustees must follow in this area, either when carrying out the full three- yearly actuarial valuation, or the annual actuarial updates. In most cases the trustees' starting point will be to follow the statutory framework.
   - The strength of the employer's covenant – in this area legislation is less prescriptive, and practice between different schemes varies more widely. Over the last few years trustees have generally acknowledged that it is important to have a good understanding of the employer's covenant.

Trustees of a DB scheme should be clear about which option of Buy-out or continuing company sponsorship is more likely to apply for them. For many schemes, the likelihood of ever being able to buyout or partial buy- in benefits will depend on the prices that insurance companies charge for these, and those prices change over time. Just as significantly, most trustees will find that the attitude of the sponsoring company has a strong bearing on the route that the trustees follow. Some companies take the view that, even if they could afford to pay the buy- out deficit, they would not be willing to do so – since it represents an extra up-front cost to the company, which could be avoided by continuing to run the scheme off over the coming decades.

The risk position of the membership numbers, funding position, scheme liabilities and covenant relationship has also been made more complex for some schemes as many of their DB members are exchanging their DB benefits into external DC transfers or requesting an internal conversions to scheme DC benefits.

1.5.2 Investment Risk For Defined Benefit (DB) Schemes

Whichever options the trustees follow, an important part of their risk management will be to consider the way the scheme's assets are invested. If they are looking to follow option to buy out the scheme's benefits, they may well first need to manipulate the scheme's investments to raise the funding level, until they are at the point where the remaining buy-out deficit is small enough for the company to be willing to pay. Alternatively, if buy-out is not an option, an essential part of the actuarial valuation process is to identify the amount of investment return that the scheme expects to get in the coming years.

The expected investment return is normally linked to the level of risk associated with the investments.

For example, if the sponsoring employer is very strong, the trustees may be willing to operate a riskier investment strategy, which generally will mean they can assume a higher investment return over time – and therefore can set a lower target funding level now. If the trustees have concerns about the employer's covenant, they are more likely to pursue a low-risk investment strategy (e.g. investment in bonds and gilts), meaning that the expected investment returns will be lower, and therefore that the sponsoring company must pay a higher level of deficit contributions. This is reflected in TPR's December 2015 guidance on integrated risk management, and the code of practice 03 'Funding defined benefits' which remains in force and currently under consultation and review.

When trustees decide their strategies for managing investment risk, there are various options open to them, some of which have become increasingly sophisticated in recent years. The options include:

- **asset split** –trustees must decide the split between return-seeking assets (e.g. equities) and safer, lower return assets (e.g. bonds and gilts). They should review this regularly, and change the split as necessary.
- **hedging** – many schemes now use some form of 'hedging'. This is a loosely defined term, but for a pension scheme it essentially means using assets in a way that is designed to protect against certain unforeseen or unwelcome events. (And it is important to understand that pension schemes use hedging as a way of reducing risk – and not for investing speculatively as happens in some "hedge funds" elsewhere in the investment world.) This protection can take many forms. The most obvious forms of hedging are investment arrangements designed to protect the value of the trustees' assets against future changes in interest rates, inflation levels or currency exchange rates. Another specific form of hedging is a 'longevity swap', which is a contract that a few schemes have entered to guard against uncertainty over future mortality rates.
- **liability driven investment** – larger schemes, in particular, have recently shifted towards a more sophisticated form of investment which is based on predicting the level of benefits that the scheme will be required to pay its members at each point in the future. The scheme's investments are then set up in a way that is specifically aimed at giving investment returns that enable the scheme to meet its predicted cash flows during each time period. This usually involves some hedging arrangements. This approach is known as 'liability driven investment'.

- **Buy-in of pension liabilities** – this involves identifying a particular group of liabilities within the scheme (for example, the pensions that will be payable to the scheme's current pensioners) and then buying an insurance policy which will pay those liabilities. Under a buy-in, the insurance policy is held by the trustees as an asset of the scheme. This is different from a buy-out in which the members cease to be part of the scheme, and legal responsibility for paying their benefits passes entirely to the insurance company. A buy-in gives added security for the trustees, because it protects them against the risk that pensioners might live longer than expected. Apart from a longevity swap, which is generally a more expensive bespoke option and has therefore been used only by a small number of schemes, a buy-in is the only way for an ongoing scheme to have this protection against mortality risk. A buy-in will often involve the sponsoring employer making a lump sum payment to help fund the cost of the insurance policy. A Buy-in policy is held by the trustees which acts as a scheme asset paying the member benefits. However, the duty to pay members still remains with the scheme and members under pensions law would still face the risk of their benefits being scaled back if the employer became insolvent at some point in the future.

1.5.3 Sponsoring Employers' Attitudes To De-Risking

In all these areas, it is increasingly recognised that it is not just in the trustees' interests to review and manage the risks effectively, but also in the sponsoring employer's interest. The accounting rule which requires employers to show pension liabilities on their profit and loss account (the IAS19 International Accounting Standard rule) means that, over the past decade, many employers have looked at ways of reducing the volatility of their pension scheme funding. In some cases this has led the employer actively to encourage the trustees to move to a liability driven investment strategy, or to take other de-risking steps such as a buy-in, and employers will sometimes be willing to pay the extra funding costs associated with doing this.

That said, there are still many cases where the sponsoring employer would prefer to pay contributions that are as low as possible in the short to medium term, and will stick closely to this negotiating approach in the discussions about the three-yearly actuarial valuation.

Some employers have looked at another method of de-risking, which involves taking steps to reduce the scheme's liabilities, in other words the benefits payable from the scheme. Very many employers have now stopped future accrual under their DB scheme. Once accrual has been stopped, the two highest profile ways for employers to reduce scheme liabilities are: (i) a pension increase conversion exercise, in which members are invited to exchange part of their future pension increases for a one-off uplift to their pension, or a lump sum payment outside the scheme; and (ii) a transfer value exercise, in which members are invited to transfer their benefits to a different pension arrangement. These are generally proposals that a sponsoring company would bring to the trustees, rather than something the trustees would do at their own initiative. Unlike some of the other de-risking approaches mentioned in 1.5.2, the trustees will not necessarily conclude that the company's proposal is in scheme members' interests. The DWP and TPR have consistently shown concern about the need to ensure that pension increase conversion exercises are consistent with members' interests, and also transfer value exercises where these include some enhancement. TPR published regulatory guidance July 2012 Incentive exercises that gave two examples of good practice January 2016 Incentive exercises for pensions: a code of practice (the 'Industry code') and January 2016 Incentive exercises for pensions: boundary examples and other examples.

All this means that trustees of a DB scheme will need to put concerted effort with expert investment and actuarial into reviewing and managing risks related to funding, employer covenant and investment, not only when carrying out the three-yearly actuarial valuation but also at other times in between.

1.5.4 De-Risking And Data Quality

The job of a pension scheme is to pay the correct benefits, and fundamentally it can only do this if the data that the scheme holds is correct.

Ensuring that data is accurate has always been a key part of the role of pension trustees, even several decades ago when there was far less red tape and regulatory guidance. As awareness of the challenges faced by DB pension schemes has grown in recent years, (together with DC schemes including large master trusts), TPR has issued various materials aimed at persuading trustees improve data quality. But at the same time, the steps being taken by trustees and sponsors to de-risk their schemes have also acted as a strong driver for trustees to improve the quality of data.

Most trustees find that data cleansing is a complex and slow process. It is important for trustees to be realistic when they set time scales and targets for data cleansing, whether they are carrying out the exercise to meet TPR's standards or as part of a wider de-risking effort.

The two drivers for data cleansing can be summarised as:

(i) guidance from the pensions regulator (TPR) with supporting guidance from PASA

TPR's guidance sets out in some detail the data quality standards that it expects trustees to reach. The guidance is an important document for everyone involved in running pension schemes. Students should make sure that they read the guidance, which is available at **thepensionsregulator.gov.uk** 'Trustees' section 'Contributions, dashboards, data and transfers' 'Record-keeping'. **(https://www.thepensionsregulator.gov.uk/en/trustees/contributions-data-and-transfers/record-keeping/improve-your-scheme-data)**

TPR's guidance has told trustees scheme data must be reviewed at least once a year with target levels set as high as 100%. Scores must be sent to TPR in each scheme return for 'common data' and 'scheme- specific data'. With the Pensions Dashboards (Amendment) Regulations 2023 there is now a need for all schemes with 100 or more relevant members to connect by 31 October 2026. This means a considerable amount of work for some schemes to get their data in order to meet any dashboard requirements. The dashboards themselves are not yet generally available to the public. Connection by providers comes first; consumer rollout follows once sufficient coverage and testing have been achieved. Current expectations remain for pubic availability after the connection programme is substantially complete.

Common data consists of the data needed so that a member can be uniquely identified: national insurance number, surname and either forename or initials, gender, date of birth, date pensionable service started, membership/policy start date or first contribution date, expected retirement/maturity date (target retirement age), membership status, last status event – the date at which the membership status last changed, address including postcode. https://www.pasa-uk.com/pasa-releases-data-accuracy-guidance

Scheme-specific data is other data needing to be build relating to members and their participation in the scheme. This is decided between the trustees and the administrator to assess your scheme and decide what scheme-specific data to keep. It may include the scheme type, structure and design, a member's status – for example, the data you need for deferred members may differ to the data for active members, events that have taken place during membership. Data relating to salary records, member options exercised and payment of benefits will also be needed.

Areas for trustees to regularly check on administrator quality controls are:

- Checking there is data in all the fields you expect
- Checking data items are consistent with each other, e.g. the date a member joined the scheme is later than their date of birth and before the date they expect to retire
- Checking data items are in a valid format, e.g. the two-letter prefix of the National Insurance number matches the ones that HMRC uses
- Having specific processes, e.g. checking a member's date of birth against their birth certificate when benefits are taken

Data cleansing has become more focused because of the need for trustees to meet the pensions dashboards deadline. TPR issued initial guidance June 2022. Dashboard duties have now been clarified and will apply to schemes with more than 100 or more active and/or deferred members and pension credit members for schemes administered in Great Britain. (**www.thepensionsregulator.gov.uk/en/trustees/contributions-data-and-transfers/dashboards-guidance**).

The PASA Data Working Group Dashboard Data Accuracy Guidance is available at **www.pasa-uk.com/pasa-releases-data-accuracy-guidance**

'Dashboarding' has a dedicated website (**www.pensionsdashboardsprogramme.org.uk/programme-timeline**) to get updates on the timelines and requirements, and an invitation to receive newsletter updates by email.

(ii) data cleansing as part of a de-risking exercise

Companies looking to de-risking will want to know how much the de-risking effort will cost them in the short term, and what its financial benefits might be over time. To do this, they will perform financial modelling based on the membership data. In addition, a pension increase conversion exercise or an enhanced transfer value exercise of the type explained in 1.5.3 involves sending an individual calculation to each member, and this can only be done properly if the calculations are based on accurate member data.

Independent of TPR's guidance, de-risking has acted as a driver for many schemes to carry out data cleansing in recent years. For those schemes and their sponsors, a welcome side effect of the de-risking exercise has been the fact that member data has been improved to a much higher standard. This should mean that those schemes will not need to carry out any further major one-off data cleansing exercises – and face the cost and time commitment involved in such an exercise – in the future.

DC scheme trustees have to be just as rigorous about the quality of data. A great danger for a DC scheme is that monthly contributions might be paid at the wrong level – for example not adjusted upwards after the member has had a pay rise or moved into a higher age band. Trustees and employers should do everything they can to limit the risk connected with such mistakes by having proper reconciliation systems that will mean that any mistakes are spotted quickly. There is a strong incentive for them to do so, because whereas a DB pension can be recalculated at any time before the member reaches retirement, it is much harder to correct a DC account with any precision, given the difficulty of working out what the investment return would have been on the underpaid or overpaid contributions.

1.5.5 COVID-19

Although no longer an issue, it is interesting to note that the COVID-19 crisis also meant TPR updated its view on the impact on scheme funding to help trustees facing difficult decisions including those if dealing with requests from employers to suspend of reduce contributions.

Where a suspension or reduction in contributions was necessary and appropriate (for example, the employer had an immediate or demonstrable cash flow need for the foregone contributions), trustees should seek protections and other mitigations. These may, for example, include:

- All dividends and other forms of shareholder distribution to stop throughout the period of suspension and not to start again until the deferred or suspended contributions have been paid.
- Where contributions have been suspended or reduced, trustees should agree arrangements for contributions to start again or increase based on appropriate triggers. For example, when access to liquidity above a certain level is restored.
- Equitable treatment of the pension scheme compared to other creditors remains a key consideration when accessing increased liquidity. Trustees should ensure the scheme is not unfairly prejudiced by other creditors being inappropriately repaid in priority. They should agree appropriate legally enforceable protections.

1.6 KEY RISKS FOR DEFINED CONTRIBUTION (DC) SCHEMES

1.6.1 Awareness of Defined Contribution (DC) Risk

In recent years there has been an increase in the awareness of risks attached to DC schemes. The defined contribution pensions (DC) market continues to radically reshape towards fewer, larger pension schemes according to new data from The Pensions Regulator (TPR).

The official statistical release, the 2024 (most recent figures) DC landscape shows the number of DC schemes decreasing 15% in 2024 to 920 – under 1,000 for the first time.

The drop in the number of schemes is primarily driven by those with fewer than 5,000 memberships..

There are 38 authorised master trusts. These account for account for 26.1 million DC memberships, including hybrids, and over £122.9 billion assets, excluding hybrids. The largest commercial master trust in the UK has grown by a third in under two years. The L&G Mastertrust has reached £30 billion in assets under management ('AUM')1, becoming the first commercial master trust in the UK to reach the milestone.

Scheme return data is published in the Research and analysis section of TPR's Document library 'Research and analysis', and includes DB pension schemes and DC pension schemes information.

For occupational DC schemes, the focus on risk has been heightened by:

- The automatic enrolment laws which have been introduced for employers from October 2012 onwards.
- A realisation within the industry that a significant number of DC schemes do not give members adequate outcomes.
- The April 2015 'freedom and choice' changes that allow members of pension schemes more flexibility about how they use their money at retirement.

With an increased focus on risk, TPR has stepped up its intervention in the governance of DC schemes.

1.6.2 Intervention From The DWP And Pensions Regulator

Prior to the general code, the most important pieces of guidance that TPR has published for DC schemes was Code of Practice 13 (no longer in force from 28 March 2024) and the associated regulatory guidance. Updated versions of these were published in July 2016,and are still available in the TPR Document library 'Scheme management detailed guidance' under the relevant section headings.

TPR's July 2016 documents took a thematic approach to DC governance which was reflected in six "how to" guides published by TPR which are headed:

- Trustee board (still available at www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/governing-body-detailed-guidance/trustee-board-guide-for-dc-pension-schemes)
- Scheme management (still available at www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/governing-body-detailed-guidance/scheme-management-skills-guide-for-dc-pensions)
- Administration (still available at www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/administration-detailed-guidance/administration-guide-for-dc-pension-schemes)
- Investment governance (still available at www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/funding-and-investment-detailed-guidance)
- Value for members (still available at www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/governing-body-detailed-guidance/5-value-for-members)
- Communicating and reporting (still available at www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/communications-and-reporting-detailed-guidance/6-communicating-and-reporting).

TPR's publications sit alongside new legal requirements that were introduced for DC schemes in 2015. The main legal requirement is that each scheme's annual report must include a "chair's statement". The chair's statement must explain how the scheme has:

- Reviewed the suitability of its default fund(s).
- Monitored core financial transactions.
- Assessed value for money of the scheme (including a statement of fund charges).
- Asked its investment managers to identify the level of transactions costs.
- Met the trustee knowledge and understanding requirements.

DC trustees should operate some form of risk register to ensure that the trustees are devoting appropriate time to the areas where the greatest risk lies. The governance framework for DC schemes is becoming more prescriptive. For instance, chair statements for DC schemes and DC SIP now require an Implementation Statement about how the DC investments are being monitored and managed. Trustees cannot treat the regulatory and legal requirements as a tick box exercise to be completed only once a year. Instead, they should keep the operation of their scheme under constant review.

1.6.3 Recent And Possible Future Changes In Governance Of Defined Contributions (DC) Schemes

As the market for DC scheme changes in the coming years, and as existing schemes become more mature, the governance required from DC trustees will continue to evolve. This is particularly true for master trusts that include a number of the highest profile and largest DC schemes in the UK. It is noted that TPR is extending some of the principles of the master trust regime to single employer DC schemes over time challenging these schemes to meet standards of master trusts and larger trusts or move members into a master trust.

Examples are:

- The authorisation regime for DC master trusts was introduced under the Pension Schemes Act 2017 and the Occupational Pension Schemes (Master Trusts) Regulations 2018. This regime built on the voluntary audit assurance framework for DC master trusts under the ICAEW's AAF 02/07 framework. From April 2019 it was unlawful to operate a master trust unless the trust has received authorisation, has an authorisation application pending, or is in winding up. The 5 criteria for authorisation laid out in the legislation were (1) demonstrating the people running their scheme were fit and proper, (2) the master trust had sufficient operational IT systems and processes in place, (3) a continuity strategy had been detailed to protect members, (4) the scheme funder could financially support it with sufficient allocated assets, (5) the master trust had a credible business strategy and plan.
- Trustees of DC schemes need to consider more precisely what outcomes their scheme is targeting, especially following the removal of the need to claim a money purchase pension as an annuity. Trustees and employers may find themselves drawing up mission statements to reflect that the way that the members of scheme might expect their investments to change over time, and how the member should expect to use his or her member account at retirement.
- Software products are available which show how the membership of a pension scheme is progressing against target retirement outcomes. This type of report might be seen by trustees as equivalent to a funding report for a DB scheme. Only a small minority of DC schemes use reports of this type at the moment. But DC trustees need to be aware of the spread of these reports, as this development may well have a significant effect on the way trustees handle governance and risk.
- It is very likely that more regulatory guidance will eventually be published on responsibilities of trustees during the decumulation phase (i.e. the period when the member starts drawing money from their pension account) as there is very little guidance focused on this area currently.
- Requirements for more detailed statements over ESG scrutiny of investments are emerging.

Summary

In the last thirty years the corporate world has seen a much greater focus on risk, and on the need for good governance.

For every organisation of any significant size, it is good practice to assess the risks that the organisation faces, and take steps to guard against them.

Pension schemes face risks of varying types. These can be broken down into five groups – operational; financial; funding (for DB schemes); regulatory and compliance.

Schemes must take action to manage these risks. It is not possible to eliminate risk entirely. But schemes should identify the main risks they face, and understand what the worst-case outcome is in each area.

In addressing risks, schemes should take a proportionate approach. In other words, the amount of energy that they focus on each risk should reflect the level of risk involved.

Principal responsibility for addressing risks lies with a scheme's trustees.

However, there will be other individuals, advisers and providers who play an important role in helping to manage risks. Depending on the company and the scheme, these can include an expert independent trustee; a pensions manager; the scheme secretariat; auditors; and the various other advisers and providers.

DB schemes face the extra element of funding risk, or covenant risk. It is essential for DB trustees to understand the strength of their employing company's covenant. The scheme's actuarial assumptions and investment approach will then need to be tailored to this.

Self Test Questions

- Give three examples of steps that a big company might take to limit its risks.
- Name three types of organisational risk that pension schemes face. Also give one type of regulatory risk, and one example of a compliance risk.
- Explain why trustees should take a proportionate approach to risks, rather than trying to eliminate all risks entirely.
- Explain why it is important for a scheme that it secretariat does a good job.
- Summarise the advantages of having an expert independent trustee.
- Give examples of steps that DB trustees have taken to manage funding risk. Explain the types of circumstances in which the sponsoring employer might be prepared to pay extra contributions to help manage funding risk.

CHAPTER 2

Good Governance

INTRODUCTION

This Chapter outlines the nature of good governance. It includes the role of TPR. It also outlines the tools available to achieve good governance.

2.1 THE ROLE OF THE PENSIONS REGULATOR (TPR)

2.1.1 TPR's General Code and Internal Controls

TPR was set up in its current form in April 2005, as part of the new legal regime introduced by the Pensions Act 2004. This was done largely in response to the growing awareness that DB pension schemes faced serious risks connected with underfunding. One of the various roles taken on by TPR involves overseeing the systems that pension schemes have in place for managing risks – known as their governance procedures.

This applies for all kinds of occupational pension schemes, including DB and DC schemes.

In November 2006 TPR published its Code of Practice on Internal Controls (Code 09) to help trustees understand how to carry out that section 249A of the Pensions Act 2004 that gave effect to the requirement under article 14(1) of the European Directive 2003/41/EC that schemes should have adequate internal control mechanisms in place.

Code 09 is no longer available and forms part of the general code that came into force 28 March 2024. Students should read the general code The governing body section 'Internal controls' as part of their learning for this subject.

(https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/the-governing-body/risk-management/internal-controls)

2.1.2 The Effect On Trustee Governance

The publication of the Code of Practice on Internal Controls in 2006 and the supporting guidance heightened trustee awareness of the need for good governance. In the past trustees might have seen their role as responding reactively to events and reports, but TPR has encouraged them to be more proactive in the way that they monitor the management and administration of their scheme, and in making sure that those providing services to them carry out their responsibilities properly.

Risk Management and internal controls have now developed considerably from 2006 so that in 2024 the general code was stating that the Chair of the trustees now has to sign off an Own risk Assessment (ORA) of the Effective System of Governance (ESOG) at least once every three years (see Chapter 1 1.1.5).

Similarly, TPR sees itself as having a proactive role. In doing so, TPR takes a risk-based approach, rather than focusing narrowly on whether a scheme meets a list of prescribed requirements. In assessing whether a particular group of trustees is doing enough to manage its scheme's risk, TPR will take into account the appropriateness of the scheme's internal controls and risk management systems.

Trustees will therefore want to make sure that their systems meet TPR's expectations, in case TPR ever has reason to look into the way the scheme is operated.

The challenge for trustees is how to keep on top of all the different risks that their scheme faces, and – as part of this – how to ensure in each area that TPR would not have concerns if it ever needed to look at their scheme. The way that many trustee boards do this, in line with TPR's guidance, is to operate a risk register as explained in 2.2 below, and now with the general code document and apply an effective system of governance.

2.1.3 Trustee Knowledge And Understanding

As well as TPR's focus on good governance, there is a legal requirement in the Pensions Act 2004 that pension trustees must have knowledge and understanding of law and practice relating to pensions, and must be conversant with the documents of their pension scheme (sections 247 and 248 of the Pensions Act 2004).This is a fairly wide topic, and the following is only a brief summary, given the connection between the "knowledge and understanding" of trustees and their ability to manage their scheme's risks effectively.

Although sections 247 and 248 of the Pensions Act 2004 set out requirements that trustees are expected to meet, they does not contain any particular sanction that trustees will face if they fail to meet the requirements (for example a trustee who fails to maintain his knowledge and understanding will not be fined). But it is generally understood that if TPR ever had reason to look into the operation of a particular scheme, one of the areas TPR would readily look at is whether the trustees took proper steps to maintain their knowledge and understanding.

To comment briefly on the two legal requirements:

- Knowledge and understanding – the requirement in the Pensions Act 2004 is, perhaps deliberately, phrased in a very general way. This was supported by a Code of Practice that was published in November 2009, and three "scope documents" that set out the areas in which TPR expects trustees to have knowledge and understanding. The Code of Practice N0. 7 Trustee knowledge and understanding (TKU) has now been replaced by the general code and expanded into two modules 'Knowledge and understanding' and 'Governance of knowledge and understanding.'This spells out that not only must an individual trustee have a sufficient level of knowledge but also the governing body as a whole can show they possess the skills, knowledge and experience to run the scheme effectively.

(**https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/the-governing-body/knowledge-and-understanding-requirements**)

- Conversance with scheme documents – again, the Pensions Act 2004 does not specify exactly what steps trustees need to take to familiarise themselves with their scheme documents. The scheme's primary document, the Trust Deed and Rules, will normally be too long for most trustees to know all the detail in full. But TPR expects trustees to have a "working knowledge" of the documents, so that they know where to look in the documents when faced with a particular issue.

Many trustees look to meet the knowledge and understanding requirements by operating a training log. This can consist of two parts: (i) a questionnaire that the trustees complete at agreed intervals (perhaps once a year) to identify whether they need particular training on any of the headings in TPR's scope documents; and (ii) a log of the training that the trustees have received, and the further training sessions planned for the next few months.

Training can be given either by the scheme's advisers and providers, or through attending externally run training sessions.

Maintaining knowledge and understanding goes hand-in-hand with making sure that the trustees have the right governance framework in place to manage their risks – and, in particular, making sure that they keep updated, and act upon, the contents of their risk register.

In February 2020 TPR published its consultation response Future of trusteeship and governance. TPR said it would revise TKU content and guidance to make clear how TKU can be demonstrated in practice, and was setting 15 hours per year as an indicative baseline for lay trustees, and 25 hours per year for professional trustees.

There are now professional qualifications to be obtained in pension trusteeship through the PMI (see section 1.2.2).

2.1.4 Further Guidance For Defined Benefit And Defined Contribution Schemes

Since it was created in 2005, TPR has also given various other pieces of guidance that have an important bearing on governance standards for DB and DC schemes. Keeping track of what TPR has issued is through the Press releases section of their website which links the press release to guidance, consultation or another issue of importance to it (**https://www.thepensionsregulator.gov.uk)** Media hub link at the bottom the screen 'News' and 'Blog' (however, the prior years archive no longer appears available).

For DB schemes, arguably the most important pieces of guidance have focused on the funding of accrued benefits and measuring the employer covenant. Trustees operating a DB scheme can have a clear focus on what they need to achieve to ensure that the correct benefits are paid out each year, and that there is sufficient money to do so. Difficulties have been posed by the worldwide financial crisis since 2008, which has forced TPR to adjust its guidance on some elements of scheme funding, but TPR has handled this in a careful way, to ensure that the guidance it issues does not cut across the measures that effective DB trustees would already be taking.

Since 2013 there has been a much greater focus on DC schemes than previously, mainly because of the automatic enrolment laws which have increased the number and importance of those schemes.

This process has illustrated the great difficulty that TPR has in giving guidance to DC scheme trustees: that the success or failure of a DC scheme is not as black and white as it is for a DB scheme. There is no simple measure of whether DC trustees have done their job 'properly'. Following on from this, it is almost inevitable that some DC schemes will work more effectively, and give better member outcomes, than others. This creates a difficult task for TPR in setting out governance principles that all DC trustees can follow. TPR's guidance applies, in principle, for all trust based DC schemes – including large and small schemes, single employer schemes and master trusts – and one challenge for TPR is how to apply the guidance for this wide range of different schemes. TPR has had a focus on costs and charges and how value for members should be regularly assessed. Finally, there is arguably an anomaly in the fact that TPR can only issue guidance for trust based schemes, and not for DC personal pensions which are regulated by the FCA.

New DC investment guidance from TPR came into from October 2019 and October 2020 with the Executive Director of Regulatory Policy, Analysis and Advice at TPR, saying: 'Good governance and the management of investment risk in pensions schemes is fundamental to provide savers with a good retirement. Climate change is a core financial risk which trustees will need to consider when setting out their investment strategy. They will be obliged to show how they are taking this and other financially material considerations into account over the lifespan of investments. This guidance provides updates as well as clarity for trustees, including considerations when planning scheme investments.' And the Minister for Pensions and Financial Inclusion, saying 'Pension schemes have a significant part to play in tackling the climate emergency. They should be thinking about how they can meet the long-term interests of their members by driving new investment in important sectors of the economy – helping to deliver sustainable environments, jobs and communities'.

As a result of this guidance Trustees must make their Statement of Investment Principles (SIP) - a scheme's investment strategy - available free of charge on a website from October 2019. From October 2020 trustees have had to produce an implementation report which explains how trustees have followed and acted on the investment policies outlined in the SIP. The SIP must include the trustees' policies on:

- Financially material considerations including environmental, social and governance matters such as climate change.
- Stewardship of investments, such as exercising rights (including voting rights) and engaging with activities in respect to the investments.
- The extent to which members' views, including ethical, social and environmental, are considered when planning investments.
- Arrangements with asset managers.

TPR's DC scheme survey (Spring 2025) reveals varied compliance.

Key findings:

- Cybersecurity: 70% have plans; 54% rely on third-party plans; <50% had trustee training.
- UK investment: 22% hold productive UK assets; only 10% plan to increase; fiduciary duties cited as a barrier.
- General code awareness: 47% aware, 28% familiar – worse in smaller schemes.
- Climate risk: <20% dedicated time to climate assessments.
- Dashboards: 87% of medium schemes have discussed; some risk missing deadlines.
- Auto-enrolment: 52% aware of age/lower earnings limit change – but no timeline exists.
- Value for Members: Smaller schemes (<£100M) must benchmark performance and governance. 19 schemes fined £97,750 for non-compliance.

Practical points:

- Review and update cyber response plans.
- Understand value-for-member rules if under £100M

.The Pensions Regulator (TPR) plans to enhance its supervision model, especially for master trusts, aiming for value for money and reduced burden.

Changes:

- DC schemes classified into 4 categories, with varying oversight levels.

Enhanced focus on:

- Data quality
- Innovation
- Retirement readiness
- Value for money
- Climate and ESG issues
- Innovation hub and targeted data requests to reduce administrative load.

DB Focus:

- More guidance on alternative models (e.g., consolidation) to come.

2.2 THE RISK REGISTER

Commentary on the need for a risk register was given in the guidance that TPR issued in June 2010 supporting the Code of Practice on Internal Controls and is seen as a key feature of 21st Century trusteeship and is now part of the general code that came into force 28 March 2024. This section of the manual gives more practical guidelines in how to create a risk register. In operating a risk register, the guidance sets out the key steps as:

Set objectives

Identify the activities that are fundamental to the good running of the scheme and decide the desired outcome for each activity.

Identify risks

Using the risk management objectives defined in the above step, assemble a full list of the risks to which the scheme is exposed. As already mentioned, these will differ from scheme to scheme depending upon the particular structure of the arrangements. As part of this process it may be helpful to identify particular individuals or posts with specific responsibilities, together with a reporting structure. For example, do the trustees want risk management reports at every meeting, or would less frequent reporting suffice? Do the trustees want to deal with these matters at the trustee board, or is there a sub-committee (such as an audit committee) to whom the detailed work can be delegated? Again, the answers to these questions will depend on the scheme and the trustees. Further comments about structures are given in 2.4 below.

Divide risks

Divide the risks into the following categories:

- Operational
- Financial
- Funding (DB schemes)
- Regulatory
- Compliance

Define the success criteria

Determine the levels of risk that are considered acceptable to the scheme in the light of the desired outcomes which have been established earlier in the process.

Assess the risks

Assess each risk on the risk register and categorise it depending on its impact and likelihood of occurring. This approach enables the trustees to identify which areas are most vulnerable and therefore need most attention and the strongest controls. It also enables them to direct most effectively their risk management efforts. Otherwise it is possible that the trustees will use resources managing a low probability, low impact risk whilst at the same time ignoring another risk that is a much higher impact (for example misappropriation of assets) and has a higher probability.

Produce an action plan

Agree the controls to be used to manage the risks and produce a plan setting out the responsibilities and timescales for implementing the controls to ensure that the required changes in procedure do take place. Many of the financial risks will already be the subject of some review as part of the audit process. However, the non-financial risks do not form part of the statutory audit process and in consequence the trustees need to decide how those other risks are to be managed and controlled.

Implement the action plan

Ensure that those people accountable for activities in the action plan carry out the plan in accordance with the agreed timescales.

Monitor and review

Monitor the effectiveness of the controls and make changes if they prove inadequate or if new risks arise.

Trustees must document what they do. They will also need to consider how public they wish to make the process of risk management. Again, the approach taken will depend on the culture of each particular scheme. Some may develop a risk management manual that is a public document designed to provide reassurance to members. Others may content themselves with making a formal statement in the Annual Report. Others still may wish to keep the process confidential to the trustees.

Whatever approach the trustees decide to take, it is essential to ensure that the system chosen actually works – and that the trustees do not fall into spending more time on the bureaucracy than on actually managing the various risks. Further comments are given in 2.4 below on the structures that trustees can use to help with this.

2.3 OTHER REPORTS USED BY PROVIDERS TO TRUSTEES

2.3.1 FRAG 21 Replaced by AAF 01/06

FRAG21 was issued by the Financial Reporting and Auditing Group of the Institute of Chartered Accountants in England, and Wales (ICAEW) in 1994. It was then updated in 1997. It gave guidance on the preparation of reports on the internal controls of investment businesses. An organisation could produce a FRAG 21 report but could choose which controls they would be assessed against and the degree to which the findings were reported. Whilst there was therefore benefit to the recipient of the report in understanding that organisation's control environment, it did not enable the customer or client to benchmark that supplier with another. These shortcomings, combined with the increased focus on internal controls, led to the issue of the AAF 01/06 guidance England. Many UK investment managers and custodians now provide ISAE 3402 type reports often instead or, or alongside AAF 01/06 reports

2.3.2 AAF 01/06 Issued And Replaced By AAF 01/20

The need for trustees to get better understanding of their scheme pension administration and fund manager's control environment combined with the increased focus on internal controls, led to the issue of the AAF 01/06 guidance in 2006 by the Audit and Assurance Faculty (AAF) of the Institute of Chartered Accountants in England and Wales (ICAEW) entitled Assurance reports on internal controls of service organisations made available to third parties. This assurance standard was replaced in by the ICAEW with AAF 01/20 for all new AAF assurance reports beginning from 1 July 2020 with updated control objectives particularly in the area of technology controls. This AAF framework covers the following suppliers of outsourced services of which third party administrators and fund managers were most relevant for pension scheme trustees wanting to demonstrate how supplier organisations were controlling risk in delivery.

AAF 01/20 has made clearer the international assurance standard the AAF is based upon the International Standard on Assurance Engagements (ISAE) 3000 (Revised) Assurance Engagements other than Audits or Reviews of historical Financial Information. AAF 01/20 is also intended to be compatible with ISAE 3402 Assurance Reports on Controls at a Service Organization.

These reports have been especially important in the light of the Pensions Act 2004, the publication by TPR of the Code of Practice on Internal Controls and supporting guidance, the need to have greater knowledge over the operational controls by third parties, and the TPR general code which now has a specific sub-module 'Assurance reports on internal controls' within The governing body section 'Risk management.'.

2.3.3 AAF 02/07 and AAF 05/20

The Audit and Assurance Faculty of the ICAEW published a further guidance note entitled 'A framework for assurance reports on third party operations' in 2007 (AAF 02/07).

This framework is significant for pension schemes for two reasons:

- Professional trustees are encouraged to obtain a report under this framework applying the control objectives set out in the ICAEW Relevant Trustee Supplement to AAF 02/07 TECH 04/13AAF Assurance Reporting on Relevant Trustees. Many prominent professional trustee firms have done so, giving additional comfort that schemes using them can expect a high level of governance.
- TPR have a request in their supervisory return questions for master trusts on control functions: "If available, please provide a copy of your most recent Audit Assurance Framework (AAF), or equivalent report summarising and signposting the key issues identified". Previously TPR had launched a voluntary framework for DC master trusts under AAF 02/07 in 2014 and invited AAF controls reporting as part of the master trust authorisation process. Assurance Reporting on Master Trusts TECH 05/20 AAF is effective from 1 April 2020 and sets out 32 detailed governance requirements for schemes to be independently assured. TECH 05/20AAF governance framework is aligned to ISAE 3000 (Revised) the international standard on assurance engagements published by the IAASB. At this stage TPR has not extended this approach to other DC schemes.

2.3.4 PASA Standards

The Pensions Administration Standards Association (PASA) has an accreditation it awards to members who can demonstrate high-quality pensions administration standards which is independently endorsed. In addition PASA publishes detailed guidance in areas such as Cybercrime & Fraud, Cyber Security, Data,DC Governance, DB Transfers, Digital Admin, GMP, Master Trust Working Group and VFM Working Group which are available at **https://www.pasa-uk.com/guidance** (and hover over the Guidance and Working Groups drop down key) and has separate sections for Dashboards.

2.3.5 COVID-19 risks and responses

As described in Part 1 1.5.5. TPR issued advice in 2020 following the government regulations for people to not work in offices and stated that activities should focus on the key risks to pension savers:

- benefits need to be paid
- the risk of scams needs to be minimised
- employers need to continue contributing
- savers need support to make good decisions in these challenging circumstances
- some administrative breaches of the law may occur and TPR would maintain a proportionate and fair approach to any action taken

In March 2020 the Chair of the PASA Cybercrime and Fraud Working Group reported a spike in cybercrime attacks during the COVID-19 health and economic emergency. Cyber criminals loaded malicious software into tracking maps, government reports and health fact sheets. New websites with variations on 'coronavirus' in their internet addresses became available have with many of them masking online scams with phishing emails and texts.

2.4 STRUCTURES USED BY PENSION TRUSTEES IN RISK MONITORING

2.4.1 The Importance Of Workable Structures

The recent awareness of risks associated with pension schemes, and in particular the increased engagement from TPR, has prompted many pension trustees to think closely about the structures they use for risk monitoring. Having a risk register is generally seen as a necessary first step, but just as important is making sure that trustees have a workable system for monitoring the different areas in the risk register, and spotting any other difficulties that might come up which are not shown on the risk register. The system that the trustees use must enable them: (i) to be proactive in anticipating and heading off risks, and (ii) to react quickly if any problems arise unexpectedly.

2.4.2 Trends

Since TPR was created in its current form in 2005, the main trends in this area are as follows:

- **the structures used must be appropriate for the scheme in question** – this seems an obvious point, but it is so important that it is worth stating first. The structures used will only serve a purpose – and the trustees will only succeed in managing risks properly – if they can be run effectively from one week and month to the next. It is essential that trustees think carefully about what structures are workable for them. This will depend on the type of scheme (DB, DC or both); the size of the scheme; the way the sponsoring employer operates, and its relationship with the trustees; how simple or complicated the scheme is, in terms of benefits, administration, investments, etc.; the size and make-up of the Trustee Board; and the personalities of the trustees, and the way they are comfortable working.
- **independent trustee** – the increasing appointment of expert independent trustees is a very important trend. Comments on this are given in 1.4 above.
- **make-up of the trustee Board** – at the most basic level, there is a legal requirement that one third of the trustees must be member-nominated trustees, as opposed to company appointed trustees (Sections 241 and 242 of the Pensions Act 2004). A scheme can have a higher proportion of member- nominated trustees, if this is set out in the scheme's trust deed, or if the sponsoring employer otherwise agrees.

However, all trustees have the same legal duties and responsibilities, whether member- nominated or company appointed. Whilst it is essential to comply with the legal requirement about the number of member-nominated trustees, in practice many Trustee Boards are finding that the more important point is not the split between different types of trustee, but making sure that the individuals on the Trustee Board can work effectively as a group. Some schemes use interviews as part of their member-nominated trustee selection process, as a way of assessing candidates, or at the very least making sure that candidates fully understand what will be required of them. Companies and schemes can face particular difficulties finding suitable company appointed trustees – especially in companies where the DBs scheme has been closed for a few years, and the majority of the workforce are not members of the scheme and have little knowledge of how it operates. It is in everyone's interests – those of the trustees, the company and the individual involved – to make sure that someone is not put forward for this role unless they will be able to carry it out effectively.

- **conflicts of duty and interest** – TPR has at various times emphasised the importance of addressing any potential or actual conflicts of duty or interest on the trustee board. The most high-profile example would be a senior officer of the sponsoring company (e.g. Finance Director or HR Director) who also serves as a trustee. That person might find himself or herself compelled to act in the sponsoring company's interests wearing a "company hat", potentially conflicting with their trustee duty to act in the scheme members' interests. He or she might also be aware of important information in either the company or trustee role which, for reasons of confidentiality, cannot be disclosed on the other side. Other examples of potential conflict can occur where a trustee is a member of the scheme (e.g. an active member who might be affected by changes to benefits; or a pensioner who could be affected by decisions about pension increases). Each scheme should have a written conflicts policy which gives guidance on how the trustees can cope with any potential or actual conflicts as they emerge.

Examples of matters set out in the conflicts policy are:

- the roles that might give rise to a conflict
- the circumstances in which a conflict might arise (e.g. changes to scheme benefits, or a restructuring within the sponsoring company)
- the steps that might be taken to address a conflict (e.g. a company officer staying in the trustee meetings but wearing a 'company hat'; or any conflicted trustee sitting out of parts of the meetings or abstaining from a vote)
- any general governance measures that may be used to help manage the risk of conflicts (e.g. use of sub-committees or an independent trustee)

Since 2011 it has also become common for trustees to include in their conflicts policy a paragraph about the measures in place to comply with the Bribery Act 2010., Corporate gifts or hospitality should not be seen as swaying the trustees' judgement about which advisers to use, or other similar matters. Many trustees also have a short anti-bribery policy setting out the circumstances in which they would be expected to report, or in extreme circumstances turn down, offers of corporate hospitality.

- **trustee sub-committees** – these are used by very many Trustee Boards. There are variations, but a typical structure might involve having, for example:
  - A governance sub-committee, dealing with a wide range of miscellaneous action points connected with the running of the scheme (monitoring administration of benefits; overseeing the annual report and accounts; dealing with significant member complaints, etc.).
  - An investment sub-committee. In most cases this will carry out the legwork connected with the scheme's investments (e.g. monitoring investment managers' performance; receiving reports from the investment consultants; exploring possible changes to investment strategy) but decision making powers will lie with the full trustee board.
  - A benefits sub-committee, whose job is to make decisions about death benefits, incapacity cases etc.
  - A communications sub-committee that manages member engagement and communications.

Delegating work to sub-committees helps to make sure that the main trustee meetings run to time. And most schemes hold their main trustee meetings on a regular basis (e.g. once every 3 or 4 months), and sub-committees enable tasks to be carried out during the periods between the main meetings, rather than being bunched up until the next meeting.

When setting up sub-committees, trustees will need to consider:

- Which sub-committees to operate
- What tasks each sub-committee will carry out
- Whether the sub-committee will have decision-making powers, or only carry out legwork and report back to the main Trustee Board
- How many trustees should serve on each sub-committee
- Who the sub-committee members will be

Typically, these points will be recorded in a document for each sub-committee, often known as a terms of reference. All members of the trustee board have legal responsibility for the trustees' actions, whether or not the individual trustee is on the sub-committee concerned.

2.4.3 Structures To Help Newly Appointed Trustees

Many pension schemes face a particular challenge in setting up a structure to help trustees newly appointed to the board. A similar challenge is faced by any pension scheme that undergoes a merger with another scheme – or where the sponsoring company operates two or more schemes, and decides not to merge them, but instead creates a combined trustee board to run the separate schemes. In these cases, the trustees will need to understand the way that both schemes operate, not just the scheme for which they served as a trustee previously.

The steps that trustees take to meet this challenge, and the structures they use, should take into account the legal requirement for all trustees to have adequate knowledge and understanding, and be conversant with the scheme's documents.

It is common for schemes to do two things to assist any trustee newly appointed to the role. First, the new trustee can be provided with a pack of documents which explains, in a user-friendly way, how the scheme works – including an overview of areas such as scheme benefits, recent funding discussions, how the scheme's assets are invested and so on. Secondly, many schemes arrange for newly appointed trustees to attend some form of training, and various firms of pension consultants provide commercially-run training sessions aimed specifically at new trustees.

In February 2020 TPR published its response to its consultation on Future of trusteeship and governance.

TPR acknowledged that the concept of TKU (Trustee Knowledge and Understanding) had not changed in the 15 years since it had been introduced, even though the laws and risks facing pension schemes had.

TPR announced that it would make clear their expectation for the content and level of TKU that trustees needed to attain, both professional and non-professional trustees. The single code project of TPR aims to consolidate all the 15 Codes of Practice into a single web-based code is in process with ten of these codes now forming the general code that came into force 28 March 2024.

TPR said that it would not change current TKU legislation and will articulate a range of acceptable methods for demonstrating TKU such as completion of the Trustee toolkit, relevant work experience and other industry-based training. Different options for demonstrating TKU helps to reduce barriers for participating in trusteeship and support board diversity. TPR has setting 15 hours per year as an indicative baseline for ongoing learning for lay trustees. Professional trustees are expected to follow the industry- based standards on ongoing learning, currently set at 25 hours per year, and 5 hours of reflective discussion with a fellow trustee is also becoming a requirement for APPT accredited trustees from 1 July 2024.

2.4.4 Impact Of The Pension Schemes Act 2021

The Pension Schemes Act 2021 (PSA 2021) became law in February 2021 and many of the provisions are coming into force. For instance , the tax treat of the collective money purchase arrangement (also known as collective defined contribution (CDC) schemes) is a new type of pension provision introduced , and Finance Act 2021, Schedule 5 (Pension Schemes: Collective Money Purchase Benefits)(Appointed Day) regulations 2022 SI 2022/874 appointed 1 August 2022 allows for the CDC pension tax relief provisions to operate fairly. The wide-ranging nature of this will impact the risk assessment, processes and controls related to the regulated requirements. There are new criminal offences, for instance, of up to 7 years in prison and/or a fine of £1millon for putting accrued benefits at risk, and up to two years in prison and a fine for knowingly or recklessly providing the Regulator with misleading information. The Act amends the scheme specific funding regime of the Pensions Act 2004 and will sit alongside a new DB funding code.

Regulations have been issued in relation to climate change. Schemes with net assets exceeding £5billion at the scheme year ending on or after 1 March 2020, authorised master trusts and authorised money purchase schemes need to comply from 1 October 2021 with the requirements for trustees to assess, manage and report on climate-related risks in line with the recommendations of the taskforce on climate- related financial disclosures (TCFD). Schemes with net assets exceeding £1billion at the scheme year ending on or after 1 March 2020 need to comply from 1 October 2022. The TCFD report is due in these cases within 7 months of next scheme year-end.

2.5 THE CHANGING FACE OF TRUSTEESHIP

The Pensions Regulator (TPR) announced plans (Spring 2025) to extend oversight of professional trustee firms, establishing supervisory relationships which key firms started in summer 2025, and expanding by year-end. They have not been replaced by new legislation, rather, they form part of TPR's broader move towards a prudential, market-wide supervisory approach

TPR's market oversight report finds:

- ~50% of UK pension schemes have a professional or sole trustee.
- Sole trusteeship is growing.
- Professional firms manage £1 trillion+, with £75 billion by sole trustees.

Key concerns:

- Employer relationships – safeguarding trustee independence.
- Profit/remuneration models – commercial incentives may distort service quality.
- Sole trusteeship – internal controls and motivations behind appointments.
- In-house advisers – potential for conflicts of interest.
- Decision-making – governance knowledge, delegation appropriateness.
- TPR will clarify expectations and may use appointment/removal powers if material risks remain unaddressed.

Practical points:

- Trustee firms should continue to engage.
- Sponsors/trustees should monitor emerging guidance.

The basic governance requirements for TCFD reporting in section 124 of PSA 2021 will involve:

- **governance** - Schemes to establish, maintain and disclose the trustees' governance around climate-related risks and opportunities
- **strategy** - disclosure of the actual and potential impacts of climate-related risks and opportunities on the pension scheme
- **risk management** – how the trustees identify, assess and manage climate-related risks
- **Metrics and targets** – disclosure for material information of the metrics and targets used
- **TKU** – trustees to have the needed knowledge and understanding of the principles relating to climate change for risks and opportunities.

The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 and the Occupational Pension Schemes (Climate Change Governance and Reporting)(Miscellaneous Provisions and Amendments) Regulations 2021 introduced new requirements for certain trustees. A TCFD or climate change report is required from 1 October 2021 for trustees of schemes with assets over £5billion, and authorised master trusts. Schemes with assets over £1billion are included in the TCFD governance reporting requirement from 1 October 2022.



Summary

Since April 2005 TPR has taken a strong lead in trying to improve pension scheme governance and the general code that combined ten previous codes of practice came into force on 28 March 2024. This did not include Code 03 Funding defined benefits or master trusts Code 15. Under the Pensions Act 2004 trustees must have knowledge and understanding of the law and practice relating to pension schemes, and they must be conversant with their scheme's documents. TPR has published a scope document that lists the areas in which trustees should build up their knowledge and understanding.

Trustees should also operate an effective system of governance and own risk assessment which includes monitor the governance standards of their providers, for example by asking to see industry standard reports such as AAF 01/20 (previously AAF 01/06), ISAE 3000 (Revised) and PASA Accreditation.

In order to make governance standards as high as possible, trustees will need to consider the structures that they use. For example, they should think about the make-up of the trustee board, its diversity, and whether they have an expert independent trustee, and their use of sub-committees.

Self Test Questions

- Summarise the main steps that TPR expects trustees to take in managing risks.
- Consider a pension scheme of which you are a member or one that you work on. Are you aware of their approach to risk management? Do you know what the high impact, high probability risks are for that scheme? If not, see if you can obtain a copy of a trustees' risk register and, if possible, understand the process they undertook to compile the register and what the review process is.
- What different types of sub-committees do trustees use? How can these help in maintaining good governance?

Part 2

COMMERCIAL ASPECTS OF OPERATING A WORKPLACE PENSION SCHEME





OVERVIEW

For those whose job involves co-ordinating the efforts of the different people involved in running a pension scheme, it is essential to have an understanding of how work should be divided up between different specialists, how to ensure that they carry out their individual roles effectively, and how to succeed in getting them to work together, within a defined budget.

This part starts by looking at service delivery, and the methods used to monitor and reward performance, and guard against underperformance. It touches on the ways that customer surveys can be used to measure the customer experience, and how customer complaints and disputes are most effectively resolved.

This part then looks at the other commercial aspects involved in running a pension scheme. Costs have become increasingly important for sponsoring employers and trustees alike – particularly in the recent years since the economic crisis that began in 2008 and have re-emerged from 2020 with the COVID-19 crisis, slow down economic growth and costs to transition to net zero. Guidance is also given on how budgets can be set and monitored, and how costs can be controlled effectively.



CHAPTER 1

Service Delivery

INTRODUCTION

This Chapter outlines the governance aspects of service delivery. This includes coverage of service level agreements, performance measurement, reporting and contract remedies. Finally, it outlines some of the various quality management systems available.

1.1 SERVICE LEVEL AGREEMENTS

A service level agreement is a way of creating a common understanding, usually between two parties, about services being provided and service delivery. It is a tool which helps:

- Manage expectations
- Clarify responsibilities
- Provide an objective basis for assessing service effectiveness

As an example, a pension administration service provider may wish to agree turnaround times with its client for processing data and provision of information. Typically, in the current market, these are better than those specified in the Occupational Pension Schemes (Disclosure of Information) Regulations 1996. In doing so, and to meet the expectations created, they might agree that the information they require to carry out a particular activity must be presented in a particular format and within certain specified timescales in order for the turnaround time to be measured. If this cannot be achieved, then the expectation that the data will be processed within the agreed timescales may not be met.

It is important to always bear in mind that there is a member waiting for that information or payment so good, regular communication about progress of a case, particularly where delays are incurred, is very important.

A good example of the importance of the service level agreement (SLA) is where this contains a turnaround time for the investment of contributions in a DC scheme. This has taken on an extra focus with the introduction of automatic enrolment from 2012 onwards meaning many new members coming into schemes, and new providers in the contractual chain (data assessors, payroll, benefits platform providers etc.).The SLAs will only apply from the date complete, clean data is received so if the data comes in piecemeal or there are lots of queries on it this will delay the investment of the contributions.

It is really important with SLAs to remember why they exist. In the example above the measurement against the SLA should highlight the issue i.e. poor or incomplete data and should be the driver to changing process or behaviour.

Whether the timescales are met or not may be measured by means of a work logging system which gives the date on which the work came in and the date on which it was issued. When reviewing the content of the SLA it is important to bear in mind, particularly in the case of the administration service, the member's perspective and ensure that reportable timescales built in will reflect their view of the service.

1.1.1 Manage expectations

Although a service level agreement is a good tool for managing expectations, it is important also that the provider of the service manages its own expectations of what it can reasonably accomplish by considering:

- The services provided
- Service standards, such as timescales within which services will be provided
- An agreed cost for the provision of the service specified in the agreement.

1.1.2 Clarify Responsibilities

The service level agreement must be clear regarding responsibilities. It will be impossible for the parties to the agreement to work together if this is not the position. It could create more problems than it solves, as it could be a basis for future conflict.

If responsibilities are clear, the agreement will help alleviate or even avoid disputes by providing a clear understanding of needs and priorities of the parties to the agreement. If conflicts do occur, they can be resolved more readily.

Often the service level agreement will be supported by other documentation e.g. an administration manual which sets out in more detail how processes between the provider and the client will operate and where responsibilities lie.

1.1.3 Provide An Objective Basis For Assessing Service Effectiveness

A service level agreement has to have goals. It is vital to set targets which give customers satisfactory, or at least improved, performance and that clearly demonstrates that their objectives for the service have been met. Goals not relevant to those objectives or with measures set too low (or too high) will be meaningless as they can be achieved easily, not at all or will not be perceived as adding any value to the service.

The agreement must be one which all parties can live with and the negotiation of the agreement will be an important first step in a successful ongoing relationship. The service provider must be aware that expectations of customers can sometimes differ from the norm i.e. what is set out in the standard agreement and so it is equally important that the agreement allows for the testing and subsequent review of those expectations.

Tracking the performance against the agreement must be simple but evidence based. Using software tools to automate the process saves time and reduces errors and conflict.

1.1.4 Ensuring That There Is Clarity On Cost

If there is anything likely to impact on a successful relationship it is disagreements about costs and fees. The agreement should clearly show:

- What is included in a fixed fee in terms of services and volumes (if operating on a fixed fee basis) or the basis for time cost charges including hourly rates
- Frequency of billing and payment terms
- How frequently and on what basis the fee will be reviewed
- What the process is for notifying the customer of additional fees and how these will be calculated

The important thing to remember is that customers do not like surprises when it comes to fees therefore advance agreement and early notification of any additional fees is far more likely to be well received and if the requirement for extra charges can be made clear because there is a well-constructed agreement then the whole process becomes much easier.

1.1.5 Establishing An Agreement

Service level agreements thrive on simplicity but establishing an agreement is neither a quick nor simple process. Attention should be paid to the following key steps:

- **gather background information**

  Both the customer and service provider need to start by gathering information so that each has a base from which to negotiate. Customers will need to review and clarify their service needs and objectives.

  Service providers need to determine the level of service they can realistically provide, what they can measure and how they are going to evidence that measurement to their customer.

- **ensure agreement about the agreement**

  The parties to an agreement can have different views about the role of the service level agreement and what it can realistically accomplish. Is it solely to be used as a benchmarking tool or is it designed to drive continuous improvement? The parties should first hold an open discussion to ensure that they are comfortable with the focus of the agreement.

- **develop the agreement**

  The result of this step is a draft of the agreement which will then be negotiated and the document will be finalised. Increasingly both customer and provider will involve their legal advisers, either internal or external in this part of the process.

- **implement and manage the agreement**

  An agreement which is not managed dies on implementation. Management responsibilities include providing a point of contact for problems related to the agreement, conducting service reviews and, in the light feedback received from those carrying out the reviews, agreeing whether the detail of the agreement remains relevant or needs amending. One individual will then need to take responsibility for coordinating and implementing modifications, reviewing whether the fee structure remains appropriate and assessing and reporting on the scope for ongoing improvement to both the relationship and service delivery.

  Procedures, and indeed the agreement itself, should be as simple and easy to understand as possible.

- **check how warranties and penalties operate**

  If SLAs are not delivered or other problems arise, check how much the service provider will compensate the scheme for the failure to deliver the expected service, and the cost of producing 'work arounds' to resolve what is not being processed to the required delivery time or quality.

Occasionally, an agreement may be implemented at the wrong time, for the wrong reasons and in the wrong way:

- **Wrong time** - Service providers sometimes want to create a service level agreement to suppress customer complaints. This can backfire because customers may see it as just one more thing to complain about. Complaints should be resolved before establishing a service level agreement.
- **Wrong reason** - Sometimes something less than a service level agreement will suffice e.g. service standards.
- **Wrong way** - Most service level agreements are unilateral and unilaterally established by service providers. The customer is given little or no say about either the content of the service level agreement or the process by which it is established or managed. This is the wrong way to be successful with a service level agreement. In simple terms, if the two parties have not agreed, it is not an agreement.



1.2 THE AUTOMATIC ENROLMENT SUPPLY CHAIN

A new dynamic is added to service delivery by the automatic enrolment laws that have applied from October 2012 onwards. These new laws do not mean a fundamental change in service delivery, but they make the existing relationships between suppliers more complicated.

The key points to bear in mind are:

- The employer has the legal duty to ensure that the automatic enrolment obligations are met. If there is a compliance breach, then the risk of a fine or adverse publicity falls on the employer.
- The pension provider will, in practice, take on certain responsibilities to ensure that the employer's automatic enrolment obligations are fulfilled. But most of the tasks carried out by the provider will be as a delegate of the employer. The risk of non-compliance still falls on the employer.
- Other providers may well be involved in the supply chain. For example, these might include the payroll provider; a separate data hub, if the employer decides to use one; scheme administrators (if there is a trust based scheme); annuity broking service at the point of retirement.
- The scheme trustees will have a key role (where a trust-based scheme is used). But there will be various ways in which the trustees are reliant on the employer or its delegates to ensure that the automatic enrolment obligations are met fully. For example, trustees would not expect to take responsibility for monitoring the earnings of workers to determine whether they are eligible to be automatically enrolled.

This all increases the onus on the employer to monitor the various relationships in the automatic enrolment supply chain, and to ensure that the SLAs at each stage are being met.

For example, employers will need to:

- Ensure that there is a written contract in place for each step in the supply chain.
- Make sure there is a fool proof system in place for reconciling key transactions (e.g. monthly payment of pension contributions; annual changes to contribution levels; prompt investment of contributions in the correct funds).
- Make sure that other risks in the supply chain are highlighted and addressed as necessary. For example, the employer should ensure that a proper level of data security applies at each stage of the supply chain.
- Decide what type of internal structure to use for overseeing the automatic enrolment arrangements. For example, larger employers may decide to use a governance committee which meets on a regular basis and monitors certain specified areas (e.g. operational matters; investment options; communications to employees).

Setting up systems of this type will reduce the risk of an error occurring without coming to the employer's attention.

1.3 THE TYPE, ROLE AND VALUE OF PERFORMANCE MEASURES

Performance measures remain essential because they form the backbone of effective performance management. Performance management involves tracking performance against agreed targets and identifying opportunities for improvement, but it is not simply a retrospective exercise. The focus is on the future — what needs to be achieved, how capability must evolve, and how services can be delivered more effectively. Managing performance is fundamentally about managing for results.

Current regulatory basis:

- TPR Single Code of Practice (2024) – Outsourcing and Delegation, Governance and Reporting of Trustees, Risk Management, Operational Resilience
- Occupational Pension Schemes (Governance) (Amendment) Regulations 2024
- Pension Schemes Act 2021 (governance sections commenced 2024)

Extract from updated governance expectations (Single Code 2024):

- Performance indicators should be agreed at appointment and embedded in the service contract, with clear accountability within the provider and defined escalation routes. This includes having a documented process for managing advisers and recording decisions.
- These indicators must be reviewed regularly by an appropriate person or governance body, with outcomes recorded and actions allocated and tracked.
- Service providers and advisers should be kept under ongoing review, using detailed assessment criteria and, where applicable, key performance indicators (KPIs) and service level agreements (SLAs).

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By having meaningful performance measures you:

- Know what you are aiming for — the objectives for the service, which should be clearly defined in the SLA or outsourcing agreement.
- Know what you must do to meet your objectives — you understand members' and employers' requirements, the nature of the services being delivered, and how the provider's operating model supports those requirements.
- Know how to measure progress towards your objectives — an important aspect of setting up the SLA is ensuring that the provider has the capability to produce accurate, timely measurement information.
- Can detect performance problems early and remedy them.

Implementing performance measures inevitably has an associated cost, so it is important to agree at the outset what the critical success factors might be. These might include:

- Focusing on outcomes that meet objectives, rather than simply outputs.
- Defining and using measures that evolve over time as scheme needs change.
- Measuring effectiveness (doing the right things) and efficiency (doing things right) in parallel.

In setting up the performance measurement system trustees can use these evaluation criteria for measures and metrics. These include:

- Measuring the right thing.
- Having the right measures.
- Using the measures in the right ways.

Any performance measurement system must drive the right behaviours. For example, if the only measure is timeliness, then those delivering the service may focus on getting work out on time at the expense of good customer service or failing to recognise a member's priorities. The same applies to any performance penalties, which should be used as a tool to restore an underperforming aspect of a service to desired levels, not as a 'big stick' to punish the provider.

It is often forgotten that there should be both internal and external reportable measures. Examples of external measures include:

- Timeliness
- Member satisfaction
- Regulatory compliance
- Age of work
- Complaints
- Compliance

These are also valuable internal measures, but a management team is likely to require additional measures such as:

- Profitability
- Efficiency (e.g. throughput of work)
- Levels of outstanding work
- Levels of rework
- Staff turnover
- Staff satisfaction

1.4 REPORTING

Over the years, the quantity and quality of information required by customers has grown enormously. Reports may be required to provide analysis and explanation of why something was done, how it was done, what impact it had and how it compared with expectations.

It is important to remember that the reports:

- Are read by busy people so it is important that they are concise and easy to read. The use of colour and graphs can substantially improve the appreciation of the information being provided.
- Should demonstrate through evidence-based reporting how the objectives for that service for the scheme have been met.
- Must concentrate on the key areas of the service as agreed between the service provider and the customer.
- Should be precise, relevant to the service delivery provided and state the service level objectives and whether they have been met relative to the agreed measures.
- Highlight any areas on non-compliance e.g. regarding disclosure or pension legislation requirements.

A stewardship report may be presented to a client at agreed intervals and state how actual performance has compared with the performance set out in the service level agreement. In addition, it may cover other matters such as:

- Number and type of transactions dealt with and how any discretionary benefits e.g. on death, have been dealt with.
- Percentage of individual cases or scheme events completed within the agreed targets.
- Fee information such as fees accrued on a particular project compared with the agreed budget.

The report may also highlight any areas of achievement, special exercises such as provision of data for an actuarial valuation, redundancy exercises and so on.

Traditionally stewardship reports have largely focused on what has happened in the past. However, it is equally important that this is used as a tool to keep trustees and scheme sponsors informed about forthcoming work such as pension increases, benefit statements and so on.

Stewardship reports are a very valuable tool for trustees, but they are backwards looking. In addition quite often there is a time lag of at least a month between the end of the period covered by the report and the date it is issued and quite often it is even longer before trustees formally consider this at a meeting. The stewardship report is not a replacement for good interim reporting and should largely confirm information the client is already aware of. A customer should not find out via their stewardship report that, for example, there are additional fees being incurred or that there has been a dip in performance during the period.

It is almost impossible to be prescriptive about what constitutes good interim client reporting as this will vary significantly from client to client and will depend on the nature of the services being provided. Some interim reporting mechanisms that could be considered include:

- Monthly provision of service level agreement performance figures
- Provision of updated issues logs
- Annual planners showing key scheme events which are updated on a regular basis
- Planned telephone calls to discuss current issues and service level
- Project reporting
- Service review meetings

It is unlikely that any one client will require all of the above but, part of making the agreement work on a long term basis, will involve making sure that there is regular communication in the right format and on a pre agreed frequency which will ensure all parties are up to date with the service.

PASA issued guidelines on service agreements with pension administrators in April 2019 feature the Service Agreement that can be found in the 'Standards' section of the PASA website **https://www.pasa-uk.com/wp-content/uploads/2022/01/1.1-Agreements-Oct-2021.pdf**



1.5 CONTRACT REMEDIES

The basic common law remedy for breach of contract is damages. In an action the plaintiff can recover financial compensation for his actual loss, provided it is not too remote. The following examples illustrate this point:

- In Hadley v. Baxendale (1854) a broken crank shaft was delayed in transit due to the negligence of the carrier. In the resulting court case, the rule was laid down that damage is not too remote if it was the natural consequence of the breach, or if it was something that should have been foreseen by the parties (at the time the contract was made) as likely to occur.
- The importance of this aspect of remoteness must be emphasised, particularly in the light of the case of Victoria Laundry v. Newman Industries (1949) where it was held that due to the late delivery of a boiler needed to expand the business, the consequent loss of A's ordinary profits could be recovered from B but not loss under a special contract between A and C which B did not know about, since B could not be expected to have foreseen the loss.

A party suing for damages is under a duty to mitigate or reduce the loss - e.g. if goods are damaged and a chance to sell them comes along he should do so and recover only the difference in value between the goods as they should have been and the goods as they were.

In appropriate circumstances, an equitable remedy will be available. There are four of these:

- **specific performance** - is a court order that compels a defendant to perform his side of the contract.
- **injunction** - this is a court order and is usually negative or prohibitory, i.e. forbidding a person to do something. Occasionally, mandatory (or positive) injunctions are granted, but courts are reluctant to grant these, because of the supervision involved. It is important in the law of contract to restrain a proposed breach of contract. For example, in Warner Brothers v. Nelson (1937) an injunction was granted to prevent a film star making films with any other company because the contract was an exclusive one with the plaintiffs.
- **rescission** - means the setting aside of the contract. Under this equitable remedy, an innocent party may escape from his obligations under a contract because there has been fraud or mistake. It also applies where there has been a breach of a condition of the contract, or where there has been a failure in performance (which may or may not be a breach) which has deprived the injured party of 'substantially the whole benefit of the contract' - Photo Production v. Securicor Transport Ltd (1980).The effect of rescission is not that the contract is completely void but that the parties are released from any future obligation to perform the contract. The injured party will still have the right to damages for loss caused by the performance which has been rendered.
- **rectification** - if a contract as drawn up does not reflect the clear and mutual original intentions of the contracting parties, the Court will allow a contract to be altered to bring it in line with the parties' intentions. The Court must be satisfied that it has ascertained the intentions of the parties.

Equitable remedies are lost if a party unduly delays in claiming them. Equitable remedies will only be ordered in certain circumstances, such as:

- Where damages could be inadequate
- Where the enforcement of the order would not require constant supervision by the Court
- Where the contract is mutually enforceable
- Where the plaintiff has himself acted equitably

1.6 QUALITY MANAGEMENT SYSTEMS

A quality management system is based on all parts of an organisation sharing responsibility for quality, and providing an effective method of acquiring and maintaining that organisation's performance standards. To enable that responsibility to be met, organisations must use every way possible to prevent, detect and correct anything which goes wrong when providing a service to its customers.

Mechanisms should be created to provide clear performance standards in all areas backed by appropriate job descriptions and training to ensure those standards are achieved.

The use of standards is becoming more and more of a prerequisite for doing business. They can be seen as a way of increasing the effectiveness and reliability of the services provided and also to provide a benchmark between one provider and another.

The International Organisation for Standardisation (ISO) is a worldwide federation of national standards bodies whose mission is to promote the development of standardisation with a view to facilitating the international exchange of goods and services. In turn their aim, amongst other things, is to enhance quality and reliability. Together with the International Electrotechnical Commission (IEC) it publishes ISO/ 9001:2015 specifies requirements for a quality management system where an organisation.

1. needs to demonstrate its ability to consistently provide product that meets customer and applicable regulatory requirements, and
2. aims to enhance customer satisfaction through the effective application of the system, including processes for continual improvement of the system and the assurance of conformity to customer and applicable regulatory requirements.

All requirements of this International Standard are generic and are intended to be applicable to all organisations, regardless of type, size and product provided. This includes organisations that provide services as opposed to actual products.

Where any requirement(s) of this International Standard cannot be applied due to the nature of an organisation, this can be considered for exclusion.

Certification to the standard reassures customers that an organisation is fully committed to quality by continuously undergoing the scrutiny of an accredited third-party quality auditor. The benefits can include improvements in:

- Service delivery
- Line management structures
- Communication, planning and administration
- Competitiveness by using ISO as an important marketing tool

Investors in People (IIP) is the UK's leading people management standard. It sets a level of good practice for improving an organisation's performance through its people. IIP was established in the UK in 1993 and was launched to produce a framework which would help organisations become more effective by developing and harnessing the skills of their people to achieve the organisation's goals. It can help support an organisation's quality programme or initiative by ensuring employees understand the strategic direction of the organisation and how their role contributes to meeting those high-level objectives. It also focuses on the quality of HR practices such as appraisal and training and development.

ISO 27001: is a specification for an information security management system (ISMS). This is a framework of policies and procedures to manage the security of information assets. Although ISO 27001 is not fully focused on IT, it is the centre piece. The protection of information is approached in the same way that a business may protect its physical and intangible assets. Controls to secure information assets will involve a HR people engagement and training, organisational and legal areas. This quality management system is awarded through independent assessment. It is the central framework of the ISO 27000 series.

ISO/IEC 27002:2022 is a supplementary information security standard that provides good practice with more detail on information security controls for use by those responsible for initiating, implementing or maintaining an ISMS.

Cyber Essentials is a UK government-backed and industry supported scheme to guide businesses in protecting themselves against cyber threats. Certification against this scheme is increasingly required for any company bidding for government contracts and sometimes their supply chain too. In addition to this, other organisations are now starting to include Cyber Essentials certification as a requirement in their standard supplier contracts. Cyber Essentials is also viewed as means towards achieving GDPR compliance. There are two levels to accreditation:

- Cyber Essentials - a completed self-assessment questionnaire, signed by a board member which is then assessed,
- Cyber Essentials Plus - additional on-site testing is carried out by external certifying bodies, costs vary depending on the size and complexity of an organisation
- ISAME Governance self-assessed – Cyber Essentials with GDPR requirements.

The UK National Cyber Security Centre gives details on **https://www.ncsc.gov.uk/cyberessentials/** overview with accreditation and assistance provided by the Information Assurance for Small and Medium Enterprises (IASME) Consortium at IASME **https://iasme.co.uk/cyber-essentials/**

Unlike some other quality and assurance standards the Cyber Essentials documents are free to download to help companies prepare for accreditation.

Six Sigma

Six Sigma is a rigorous and a systematic methodology that utilises information (management by facts) and statistical analysis to measure and improve a company's operational performance, practices and systems by identifying and preventing 'defects' in processes in order to anticipate and exceed expectations of all stakeholders to accomplish effectiveness. Six Sigma is now according to many business development and quality improvement experts, the most popular management methodology in history. It began in 1986 as a statistically based method to reduce variation in electronic manufacturing processes in Motorola Inc in the USA.

At its core, Six Sigma revolves around a few key concepts.

- Critical to Quality: Attributes most important to the customer
- Defect: Failing to deliver what the customer wants
- Process Capability: What your process can deliver
- Variation: What the customer sees and feels
- Stable Operations: Ensuring consistent, predictable processes to improve what the customer sees and feels
- Design for Six Sigma: Designing to meet customer needs and process capability

Any standard or Total Quality Management (TQM) system, whether it is part of the ISO 9000 series, Investors in People or based on Six Sigma, can help control the variables (i.e. the actions of human beings) when providing a service to customers. But an organisation should go further by setting up a good quality management system, continually assess its effectiveness and audit the operation of the system. Dr Edward Deming, a 'guru' in the area of quality management systems, has stated that employees can be motivated by building quality products or providing a quality service. He was convinced that employees want to be proud of what they do. But, in service industries in particular where employees have direct contact with customers, that direct contact can soon affect a company's customer relations. As a result of this direct contact, a company must develop a means of appraising the quality of this contact through observation, feedback and customer surveys.

The plan should focus on providing action to prevent a reduction in profits. If it does not achieve this, there is something wrong with the quality management system put in place. The whole approach should be methodical, systematic and designed to function irrespective of changes in management or personnel.

Key points are:

- ESTABLISH A QUALITY POLICY: Issued by the Chairman/Chief Executive
- DEFINE QUALITY OBJECTIVES
- DEFINE RESPONSIBILITY:
- Who is responsible and accountable
- Prepare job descriptions
- ESTABLISH A QUALITY SYSTEM:
- Meet the requirements of the organisation and customer
- Establish procedures within ISO 9000/ Investors in People
- AUDIT AND REVIEW EFFECTIVENESS: Implementation of the system should be continually compared with the objectives
- IDENTIFY PROBLEM AREAS: Prepare regular audits of main operational areas to deal with potential/ real problems
- PREPARE QUALITY IMPROVEMENT PROGRAMME: Designed to meet quality objectives
- IMPLEMENT PROGRAMME: Needs commitment from management and employees - monitor progress.

1.7 BENCHMARKING

Benchmarking is the way in which a company measures its operations, products and services against those of its competitors. It is a means by which targets, priorities and operations can be established which will lead to an organisation obtaining a competitive advantage.

If a company does not know what the standard is, it cannot compare itself against it. Much of the early work in connection with benchmarking was done in manufacturing. Now benchmarking is a management tool which is being applied to almost every area of commercial activity.

There are a number of basic types of benchmarking as follows:

- **internal Benchmarking** - In most large companies there are similar functions in different business units. One of the simplest benchmarking exercises is to compare these internal operations. The objective of internal benchmarking is to identify the internal performance standards of an organisation. For example, measuring the profitability of one office compared with another within the same organisation. The main advantages of internal benchmarking are that access to sensitive data and information is easier; standardised data is often readily available: and usually less time and resources are needed. There may be fewer barriers to implementation as practices may be relatively easy to transfer across the same organisation. however, real innovation may be lacking and best in class performance is more likely to be found through external benchmarking.
- **Competitive Benchmarking** - This is external measurement against competitors. The objective is to compare companies in the same markets which have competing products or services or work processes. This type of analysis is often undertaken through trade associations or third parties to protect confidentiality.

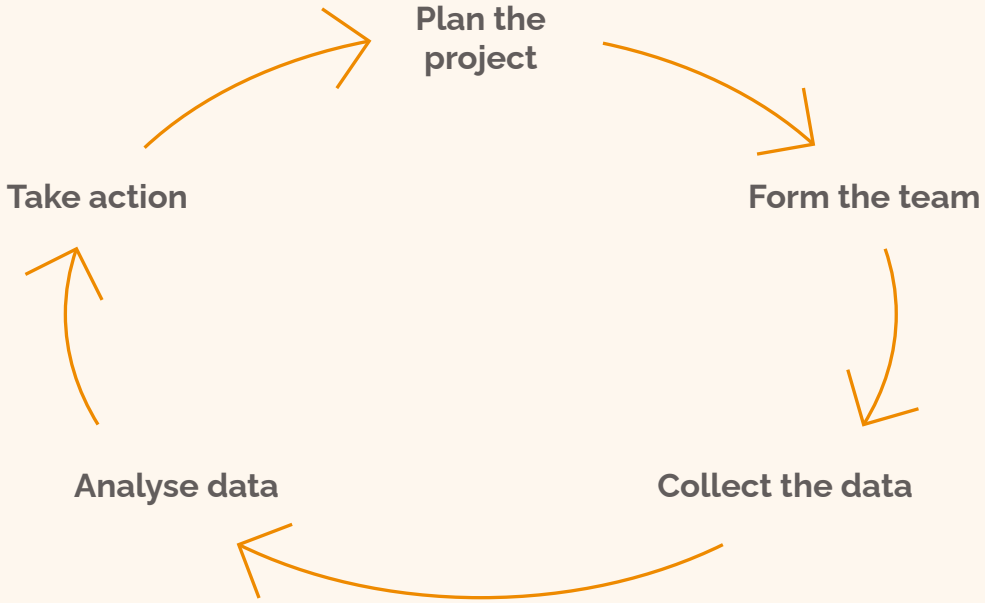
The advantage of competitive benchmarking is that a company can directly compare its performance. The disadvantage is that information can be hard to obtain.

- **Industry Benchmarking** - A company can benchmark others in the same industry who may have the same products or services but who are not competitors in the same market. It involves comparisons between firms which share some common market areas and perhaps technological characteristics. For example, France Telecom might benchmark its billing process against that of British Telecom.

  This is not widely available within the pensions industry and can typically only be achieved by employing a specialist provider of these services who will research the market on behalf of the organisation and conduct surveys to establish the organisation's position within the market.

- **Process Benchmarking** - This type of benchmarking focuses on excellent work processes rather than on the business practices of a particular organisation. Some business functions or processes are the same regardless of the industry sector. This may involve consideration of the recruitment and retention of staff in the private sector compared with the public sector. Benchmarking partners are sought from best practice organisations that perform similar work or deliver similar services. Process benchmarking invariably involves producing process maps to facilitate comparison and analysis. This type of benchmarking often results in short term benefits.
- **Functional Benchmarking** - This is where businesses look to benchmark with partners drawn from different business sectors and areas of activity to find ways of improving similar functions or work processes. This sort of benchmarking can lead to innovation and dramatic improvements.

Every organisation will approach the benchmarking process from its own perspective but generally, there are five stages in the benchmarking process:



- Plan the project - The plan should link into the quality management process and should determine what to benchmark and against whom.
- Form the team - The team structure will depend on the size and scope of the benchmarking exercise, the size of the organisation, how much is to be spent and so on. The team should be trained as necessary in the benchmarking process.
- Collect the data - One of the fundamental rules of benchmarking is to know your own processes and services before trying to understand those of another company. Then gather information about the performance and practices of the company against which you are going to benchmark.
- Analyse the data - All the collected data are used to identify gaps between best practice and your own processes or services.
- Take action - Strategies can then be developed to close the identified gaps. The tasks, resources and timescales can then be identified.

There are many ways in which benchmarking can go wrong. Some of the most common mistakes are: Confusing benchmarking with a survey. A survey will give an organisation some numbers but benchmarking is the process of finding out what is behind those numbers, to help it improve its position:

- Forgetting about service delivery and customer satisfaction. Concentration on cost reduction alone often rebounds as it can lead to a reduction in service delivery, so customers go elsewhere.
- Confusing benchmarking with research. Before it is possible to benchmark, an existing process or service delivery must have been in operation for long enough to have some idea about its effectiveness. Developing a new process simply by collecting data from other organisations is research.
- Picking a topic which is too difficult to measure. A benchmarking topic must be one which can be measured. Thus, communication to pension scheme members would be a difficult topic but the distribution of communication material could be selected.

The type of benchmarking a company should undertake depends on circumstances. Benchmarking must be seen as part of the service delivery process not just an add-on. Benchmarking should be a continuous process when striving to achieve best practice.



1.8 MARKS

1.8.1 Kitemarks

The kitemark is probably the most well-known quality mark in the world. It has been developed by the British Standards Institute as a symbol of quality and safety. A consumer who buys a product or service displaying the kitemark knows it meets the relevant specification and has been independently assessed. The BSI Group produces British Standards under the authority of a Royal Charter, which lays down as one of the BSI's objectives to:

'Set up standards of quality for goods and services, and prepare and promote the general adoption of British Standards and schedules in connection therewith and from time to time to revise, alter and amend such standards and schedules as experience and circumstances require'.

Products and services which BSI certifies as having met the requirements of specific standards within designated schemes are awarded the kitemark.

1.8.2 Plain English

In 1990 the Plain English Campaign introduced their seal of approval - the Crystal Mark - to encourage organisations to communicate clearly with the public. The Crystal Mark is now firmly established in the UK as the standard that all organisations aim for when they produce public information. The Crystal Mark will only be awarded to any document that can be read, understood and acted upon by the intended audience. Features of a Crystal Mark document will include:

- A good average sentence length (about 15 to 20 words)
- Plenty of 'active' verbs (instead of 'passive' ones)
- Everyday English
- Words like 'we' and 'you' instead of 'the insured', 'the applicant', 'the society' and so on
- Conciseness
- Clear, helpful headings with consistent and suitable ways of making them stand out from the text
- A good type size and clear typeface
- Plenty of answer space and a logical flow (on forms)

Alongside Plain English Crystal 'Kite' marks is the guideline NEST phrasebook Clear communication about pensions which sets golden rules of communication and an A-Z of alternative to jargon phrases.

1.9 CUSTOMER AND MEMBER SURVEYS

TPR have an expectation that pension schemes should have a communication plan in place dealing with how to improve or maintain member engagement. This means there needs to be processes for:

- Members' view to be heard by the trustees
- How trustees respond to member feedback, and take appropriate action
- The identification of issues and gathering of feedback from members

Customers are essential to all organisations and it is important to satisfy the needs of those customers in terms of quality, efficiency and personal service. Companies that recognise the importance of customer satisfaction ensure that proper systems are put in place to help ensure that problems do not recur.

It is essential for companies to conduct independent customer satisfaction surveys for the following reasons:

- Some problems do not get reported by customers
- Customer complaints are not always properly recorded

The way in which customer surveys are usually carried out involves obtaining responses on a wide range of issues such as service delivery, technical support, service quality, timeliness, clarity of communication and so on.

A survey should be conducted along the following lines:

- Identify whom to contact e.g. pensions manager, HR director, chief executive
- Decide what questions should be asked, these should be driven by the objectives in issuing the survey and by what the organisation needs to know. The questions may change or be added to over time but it is important to remember that changing the questions impacts on the impact to benchmark improvement. Questions might seek to find out how satisfied customers are with the service in terms of quality, reliability and timeliness; what improvements could be made to the service
- Decide how feedback will be obtained, e.g. questionnaire, face to face interview, telephone
- How often will feedback be obtained from each customer, e.g. annual, triennial

Implement and Evaluate

Listening to customers on a regular basis helps discover what they want and how they believe it should be delivered. Customers who feel they are listened to tend to feel that they are better served. Making this sort of effort enables a company to:

- Discover what is important
- Keep up with changes in customers' priorities
- Make decisions about its own business based on facts

It is not only existing customers who should be surveyed. New customers can help provide valuable information. One obvious question to ask is 'what influenced your decision in choosing us?' Similarly, customers who do not choose your company but give their business to another, should be asked, why?

Any feedback has no value unless it is shared and acted upon. Everyone in an organisation needs to know how well they are meeting customers' expectations.

In the pension administration industry there is a growing demand to carry out member surveys as part of member engagement. All too often it is assumed that 'no news is good news' in other words if there are no complaints then everything is fine. However the members themselves are the ultimate customers of a pension administration service so it is important to seek feedback from them as to whether the services offered and the quality and speed of the delivery of those services is meeting member expectations.

For a member survey to be effective it needs to be issued to the member shortly after they have had reason to interact with the administration provider. As an example, a member survey could be issued with a member's final retirement statement asking for feedback on the retirement process. Care should be exercised when deciding who should receive the survey as it might be considered insensitive to issue these to dependants in death cases. By issuing a member survey it is possible to obtain feedback on:

- Timeliness – this will help the provider understand whether the service level agreement they are currently working to is appropriate or whether certain types of cases should be prioritised over others.
- Responsiveness - were any queries dealt with in a timely manner and were all issues raised dealt with.
- Quality –was the information or communication clear and easy to understand.
- How helpful and friendly the pensions administration team were.

This feedback can be collated and shared with the trustees and scheme sponsor and can provide a scheme specific benchmark for continuous improvement.

Benchmarking across the pensions administration industry was once almost non-existent. There were some informal surveys conducted around services provided, cost etc. but very little that would actually help a client in comparing one provider against another. Clearly the acquisition of certain quality standards can provide a differentiator and can set a minimum level of service a potential customer can expect from that provider. The Pensions Administration Standards Association (PASA) initiative however has sought to introduce an industry wide member survey on the quality and effectiveness of pensions administration. This will enable participants to not only to understand how their service is perceived by their members but also to benchmark their responses against an industry wide benchmark and so identify areas for improvement.

1.10 COMPLAINT/DISPUTE RESOLUTION

1.10.1 Complaints Resolution

Part of the management and measurement of service delivery involves an analysis and resolution of customer complaints. A complaint can be defined as 'an expression of dissatisfaction whether justified or not'.

A complaint may arise for all sorts of reasons for example a benefit is not paid on time or information provided has been misleading resulting in incorrect member expectations. A complaint may not be the fault of any individual or organisation; it may be the nature of the product or investment. Alternatively, the investment or service provided may go wrong as a result of an error.

Whilst it is important to understand the root cause of a problem in the first instance the priority should always be to resolve that problem to the member or customer's satisfaction rather than apportion blame. How complaints are resolved is an important part of the system in any organisation.

The website of the Institute of Customer Service has an excellent fact sheet on Complaints handling. Key points are:

- The organisation should have a clear, flexible welcoming policy on complaints.
- Staff and management should be trained in complaints handling.
- Complaints should be given priority and dealt with by someone with the necessary authority to resolve the complaint. All written complaints should be acknowledged immediately with an indication of the timescale within which a full response will be given.
- Details of complaints should be recorded and the causes analysed so that these can be shared within the organisation and also, where necessary, with clients or third parties who might contribute to the member being unhappy.

In relation to the client or member who has made the complaint the process should be to:

- Apologise for the problem (irrespective of fault) and thank them for complaining.
- Empathise with the person complaining and do not judge them.
- Find out all the facts. It is important to bear in mind that there might be wider implications for example is this the only client or member affected, how many other instances of this problem might there be, is it likely to occur again in the future if no remedial action is taken? The investigation into the complaint should include a review of procedures to determine if something has been done in the wrong way, if something has been done which should not have been done or if something has failed to be done which should have been done. Examples are unnecessary delay, failure to follow proper procedures and a decision badly made.
- Advise the individual complaining of the outcome of the investigation. The letter of response should tell the complainant who to contact in the next stage of the process if they remain unsatisfied.
- Correct and learn from the mistake. The underlying purpose of the investigation into the complaint is to eliminate the causes of the complaint occurring again by making the necessary changes in procedures.
- Minimise reasons for complaints by having a culture of continuous improvement.

The procedures for corrective action should be in the form of general guidance and should define the duties of the managers, supervisors and key personnel. The detailed action to be taken will be dependent upon the circumstances at the time and therefore the procedures to resolve a complaint should not be too detailed.

1.10.2 Independent Complaints Resolution

If the complaint cannot be resolved within the organisation, the individual will have recourse to an independent complaints scheme. Such schemes work within a set of rules which will specify the type of complaints they can deal with. The scheme will:

- Consider the details of the case
- Ask for additional evidence (if appropriate)
- Decide if the complaint is justified
- Decide who should put matters right

The behaviour of most UK financial services institutions is regulated by the FCA. But there is a separate structure for complaints relating to pension schemes. To summarise, then, the bodies that are most likely to become involved in dealing with complaints about pensions are:

SCHEME	ORGANISATIONS COVERED
The Pensions Ombudsman	Occupational pension schemes and personal pension arrangements. Formally deals with complaints not resolved through the scheme's dispute resolution procedure. Until April 2018 there was also an important role for the Pensions Advisory Service (TPAS) which provided initial advice and conciliation for complaints about occupational pension schemes and personal pension arrangements. From April 2018 TPAS provides advice to the public but no longer deals with complaints, that part of its function having passed to the Pensions Ombudsman's team.
The Financial Ombudsman Service	Operates as part of the financial services framework, although independent from the FCA. Deals with complaints against banks, insurance companies, building societies, financial advisers and personal pension providers.

1.10.3 Internal Dispute Resolution Procedure (IDR)

Under the Pensions Act 1995, trustees are required to put in place, and disclose via the scheme's explanatory booklet, an internal scheme dispute resolution procedure under which scheme members may bring written complaints. It covers disputes between members, prospective members, trustees and scheme managers.

The trustees can choose whether to have a one or two stage process:

One stage process

The complaint must be considered by the trustees. They must issue a formal response within a reasonable time period, defined by TPR as 4 months from the date of receiving the application. The complainant must be notified of the trustees' decision within 15 working days of the decision being made.

The trustees must advise the complainant about the services of TPAS and the Pensions Ombudsman in the formal response

Two stage process

A 'specified person' is appointed by the trustees to consider the complaint at the first stage. The 'specified person' is usually the pensions manager or secretary to the trustees but can be anyone.

The 'specified person' must issue a formal response within a reasonable time period, defined by TPR as 4 months from the date of receiving the application. The complainant must be notified of the trustees' decision within 15 working days of the decision being made.

The 'specified person' must advise the complainant about how to invoke the second stage of IDR and also about the service of TPAS and the Pension Ombudsman in the formal response.

If the complainant is not happy with the specified person's decision, they can invoke the second stage of the IDR. The trustees will define the time limit for this. It is usually 6 months from the date of receiving the specified person's decision.

The second stage is dealt with by the trustees. Again, the trustees must issue a formal response within a reasonable time period, defined by TPR as 4 months from the date of receiving the application. The complainant must be notified of the trustees' decision within 15 working days of the decision being made.

If a member is unhappy with the response they receive at Stage2 of the IDR they can appeal to the Pensions Ombudsman (TPO).

TPO also provides an Early Resolution Service to settle disputes before a determination using volunteer pension professional. This came about when the TPAS dispute resolution function moved to the TPO in 2018.

Summary

It is important to have a service level agreement of some kind with external providers, particularly with a scheme's administrators. The agreement should set out expectations, how performance will be measured, and the reports that the provider should give to the pensions manager or the trustees.

If a supplier or provider breaches its contractual agreement there are various different remedies that the trustees might have. When setting up the initial contract it is important to be satisfied that it contains the right level of detail about these remedies.

Increasingly trustees and companies are encouraged to carry out benchmarking of their providers. A role in this can be played by industry standards, and other tools such as kitemarks. Along with these, trustees can also benchmark their suppliers against their competitors.

Pension schemes should consider using surveys of their members as a way of assessing how well the scheme is being operated. When carrying out such a survey it is essential to listen carefully to the answers given, and where appropriate to act upon them – and, just as importantly, to give the members some feedback on the survey results.

All occupational pension schemes must have a dispute resolution procedure, which will be based on requirements set out in legislation. Complaints should be handled carefully – since the risk of criticism from an Ombudsman can be exacerbated by poor handling of the complaint.

Self Test Questions

- Explain the different areas that would normally be set out in a service level agreement.
- What considerations can trustees take into account when benchmarking a provider against its competitors?
- Design a member survey for one of the clients you work on or for your organisation. Consider the generic questions you might ask and then any that are specific to that client's situation. Draw up a plan of the steps involved and detail how you would report back to the trustees.
- You receive a letter of complaint from a member. They have received a quotation of their retirement benefits which is lower than the previous quote they received. The date of retirement is unchanged. Consider:
- Explain the benefits and cost of Cyber Essentials to a small business owner.
- What investigations you would carry out and how you would respond to the member.
- How you would change your process to ensure that the organisation is not put in the same position again.

CHAPTER 2

Costs and Budgeting

INTRODUCTION

This Chapter provides and overview of costs and budgeting in the context of pensions delivery.

2.1 NATURE OF COSTS

This is best illustrated by an example:

Colourboxx holdings Limited has asked your organisation to run a training seminar for a group of trustees and you are required to draw up a simple budget. This is designed to determine the cost for organising the seminar although the fee charges to the client may be different if it is partly put on for other reasons: for example to strengthen the relationship with Colourboxx. In calculating the total cost it is vital that no costs are overlooked. The costs which may need to be taken into account are:

- Accommodation
- Equipment (for example, use of technology such as hiring a LitePro or other technical aids)
- Catering
- Speakers' fees
- Speakers' incidental expenses (including travel and hotel accommodation)
- Administrative staff costs
- Production and printing of handouts
- Profit margin (not a cost as such, but will impact on the price of the seminar)

Whilst some of these costs, such as catering or accommodation, may be relatively easy to quantify if an external venue is used, this may not be the case otherwise. If the training seminar is run in-house the cost of internal accommodation may already have actually been paid for but it is a real cost if the facilities used are retained for seminars and other similar events.

A different type of costing problem arises with the equipment. Clearly a projector and laptop will be used over and over again so only a small part of its cost need be attributed to any one event.

Another consideration is whether the speakers are drawn from the organisation. If so, this is likely to be the main cost in terms of the amount of their time which is spent on preparation and delivery of their session. This cost arises as their time might otherwise have been charged to clients. Therefore, the cost of their participation in the seminar could be estimated based on their hourly charge out fee rates. On the other hand, a lower figure based on the hourly cost of employing them (salary, benefits, accommodation etc.) might be appropriate. Alternatively, it could be argued that internal speakers involve no additional cost in this particular instance where other factors influence the desire to run the training seminar.

The above demonstrates that the concept of cost is complex and that the approach should depend on the objectives.

It is important to remember that, for events such as this, some form of post evaluation exercise should take place. In this example this might be an evaluation of feedback forms completed by those who attended the event.

2.2 COST CONTROL

The procedures governing the approval of expenditure and the safeguards against inappropriate or even illegal actions such as deliberate fraud are key elements of any system of cost control. Typically, there will be a scheme of delegation so that the expenditure a manager can authorise will depend on his seniority, with larger amounts being referred up the hierarchy. Expenditure not previously budgeted for might require special dispensation. For equipment there may be procedures governing how many competitive quotations are required, again related to the significance of the cost. Larger organisations may have specialist purchasing or procurement departments in any event, who monitor suppliers and negotiate terms on an ongoing basis. This has the advantage that there is the potential to negotiate benefits arising from economies of scale.

For any business the control of all payment facilities is crucial. Banks will have lists of authorised signatories and more than one signature will be required for larger amounts. The focus on this area has increased with greater requirements around money laundering. Money laundering means the methods used by criminals to hide and disguise the money they make from their crimes. The term laundering is used because criminals need to turn their 'dirty' criminal money into clean funds so that they can be used without arousing suspicion. Getting it into the financial system means it becomes harder to trace and confiscate. This impacts on individuals but, for example, trustees would also be required to meet money laundering legal requirements if they were to open a new bank account for a pension scheme.

2.3 BUDGETING

A budget is a plan that is based on estimates of future revenue and spending. It establishes the allocation of costs and expenses in relation to a given objective over a defined period of time.

Typically budgets are prepared to cover a financial year. Some companies make use of a rolling budget programme which always looks, say, 12 months ahead. It can be argued that this helps to avoid any over- concentration on the short term towards the end of an accounting year. Provisional budgets for three to five years ahead may also be prepared in some organisations or for specific medium and long term projects.

The key elements are 'Quantitative statements' which are:

- Usually in financial terms
- Covering a specific period
- For all or part of an organisation's operations
- And prepared and agreed in advance

It is worthwhile bearing in mind that budgets can be expressed in other quantitative terms such as materials, sales volume, manpower resources, as well as in the more typical financial budgets.

It is important that budgets are agreed between managers and their superiors rather than being imposed from above. It should, however, be recognised that in reality the budget process is often contentious.

Critics of the budgetary system often point to the significant resource inputs of manpower which the process itself can suck in; the tendency to focus just on the budget period, deferring or incurring costs just to meet such immediate targets.

2.3.1 Role Of Budget

The preparation of the budget is itself an integral part of the forecasting and planning process within an organisation. By breaking down business plans into their component parts and quantifying those individual elements, the organisation can:

- Control resources
- Monitor progress against strategic and operational plans/forecasts
- Take action, in relation to either costs or revenue, to bring matters back on course
- Make changes to reflect market conditions

A budget is a plan to:

- Control finances
- Enable confident financial decisions to be made and facilitate the meeting of objectives
- Ensure that there is enough money for future projects

It outlines what money will be spent on and how that spending will be financed. It is important to distinguish a budget from a forecast. A forecast is a prediction of the future whereas a budget is a planned outcome of the future.

There are a number of benefits of drawing up a budget including being better able to:

- Manage money effectively
- Allocate appropriate resources to projects
- Monitor performance
- Meet objectives
- Improve decision making
- Identify problems before they occur
- Plan for the future
- Increase staff motivation



2.3.2 Creating A Budget

Many organisations use a process of incremental budgeting in which the previous year's budgets or outcomes are used as the baseline for the new budget. Adjustments are then made for known or estimated changes such as salary increases, price changes and staffing changes. While this is a practical approach, it does contain weaknesses. Because a certain type of expenditure has been incurred or included in previous years' budget, it may not remain appropriate and necessary. It is always essential to examine critically everything which is included in the budget.

Zero-base budgeting is sometimes advocated as a corrective to the incremental approach. This means that all (or selected) aspects of inputs to the budget are costed from a zero-base (rather than from last year's spending) with each part being tested for necessity and reasonableness.

Budgets can also be constructed on a dynamic basis, so that some of the budgeted expenditure is related to the amount of the income. This would clearly happen in relation to commission or bonus payments related to revenue and it could also be extended to other areas. A department could, for example, be allowed to spend more on new business processing if there was more new business!

It is important when creating a budget to ask staff with financial responsibilities to provide estimates of figures for the budget. This helps to create a more realistic budget but also ensures greater commitment from those who are responsible for delivering the budget.

The budget created should contain enough information so that the key drivers such as costs and working capital can be easily monitored.

2.3.3 Types Of Budgets

Different types of budget may be used according to the nature of the division or department involved. The division may be designated as a:

- Revenue centre
- Cost centre
- Profit centre

Each of these can be defined as follows:

- A revenue centre might be a sales department which basically generates revenue without significant expenditure (or its expenditure is a percentage of its revenue).
- A cost centre is a division which spends but does not generate revenue. The pension department would normally be in this category although some larger organisations have allowed their pensions departments to compete for business, such as administration, so as to enable them to generate revenue and perhaps contribute to profit.
- A profit centre is a division which generates both income and expenditure so that the budget can be drawn up to show the notional profit achieved.

It is possible to convert a cost centre into a profit centre by allowing it to charge the rest of the organisation for its services. A pensions department could thus charge the operating divisions an outsourced cost for its services. This might provide incentives for those working within the cost centre but, on the other hand, it may not be realistic if the rest of the organisation has no choice in using the cost centre.

2.4 VARIANCE REPORTS AND BUDGET SYSTEMS

To use a budget effectively it is important that it is reviewed and revised frequently.

The manager responsible for a budget centre will receive monthly reports showing income and expenditure for the period and year to date compared to the budget. Good budgetary reports focus on the items where there are significant variations from the anticipated position. Income or expenditure which is not spread evenly throughout the months of the year can be 'profiled' to reflect anticipated patterns of income and expenditure.

Variances are to be expected. They may be favourable - where expenditure is lower than estimated or income higher or they may be unfavourable or adverse - where the opposite applies. In themselves variances are neither good nor bad. They serve however to highlight differences from the business plan. As such they need to be identified and investigated so that their significance for the budget centre and for the operation as a whole can be assessed. Once again, the importance of monitoring and feedback is paramount.

Even comparatively small businesses are likely to employ the full budget process, and the subsequent monthly reporting of variances. Finance staff in each of the areas of an organisation will be involved in entering data on income and expenditure and this will automatically be allocated to the appropriate profit centre. The system should also generate forecasts for the year as a whole to help put variances into context. This will require input from the budget holder in terms of advising whether, say, a positive variance merely reflects expenditure deferred or a real gain.

2.5 DEFINED CONTRIBUTION (DC) SCHEME CHARGES

Particular thought needs to be given to the costs or charges attached to a DC scheme. Generally, these are different from the other costs explained above, since they will often be paid by the members of the scheme rather than by the sponsoring company or the trustees. But the sponsoring company or trustees should still look to ensure that the charges are set at an appropriate level and give value for money. Thought should also be given to how these charges are explained to scheme members.

The sponsoring company or trustees should carefully scrutinise the changes in place and ask whether they can get a better deal for members. This is not always easy, because arguably it does not follow that lower charges are always better for members: the decision will involve weighing up whether the charges give members good value for money. And an investment fund that provides a good return with an acceptable level of risk might justify higher charges than one whose returns are not so favourable.

It is worth being aware of recent legislative developments in this area:

- from 6 April 2015, qualifying schemes under the automatic enrolment laws cannot have a charge of more than 0.75% for their default fund.
- "active member discounts" are no longer permitted in these schemes. This means by paying part of the charges for active members, but not doing so for deferred members.
- all occupational DC schemes must sign a client's statement confirming that they have reviewed charges and value for money, among other matters. This must be done as part of the trustees' annual report for years ending 6 April 2015 onwards.
- from April 2018, the Occupational Pension Schemes (Administration and Disclosures) (Amendment) Regulations 2018 (SI 2018:233) provide that trustees of 'relevant schemes' must include in the Chair's statement with Information on the level of charges and transaction costs for each fund which members are able to select (as well as the default fund); and an illustrative example of the cumulative effect of those charges and costs over time.
- The general code came into force 28 March 2024 with section Communications and disclosure 'Information to members' sub-module 'Chairs statement' which incorporated the chair's statement which stated that parts of the statement must be published online with the levels of charges and transaction costs paid by members for each defaut arrangement and fund that members are able to select with illustrative examples.

Some of the common mistakes to avoid were stated by TPR as:

Charges and transaction costs

- Only the charges for the default arrangement have been set out, and no explanation has been given as to why the charges for non-default arrangements have not been provided.
- Instead of setting out the charges for each individual fund within the scheme, the trustees have simply provided the range of charges across all funds.
- Annual management charges have been provided for each fund but there is no explanation of whether this is the only charge payable by members.

Cumulative effects

- The statement does not contain illustrations of the cumulative effect of costs and charges over time on a member's benefits
- The illustration of the effect of the charges on a member's benefits does not follow statutory guidance and no reason for this difference has been provided

Value for members assessment

- A statement has been made that the trustees believe the charges represent value for members, but no explanation has been given as to how this has been assessed.

Summary

When planning a piece of work, it is important to think through the involvement of all different parties at various stages of the work, and the costs involved in each. Costs can be agreed at the start of a project. If costs are agreed as an estimate rather than a fixed cost, careful allowance must be made for things that might happen unexpectedly during the project.

Most pension schemes have a budget for each 12-month period. It is important to plan the budget carefully. Planning a budget over optimistically (setting the figures too low) can be counter productive, as can failing to plan for contingencies. Budgets must be reviewed and kept up to date, with regular reporting of variances.

Self Test Questions

- Explain some of the considerations that might be taken into account when planning the cost of a certain piece of work.
- If one of your providers estimates that their costs for a project will be £50,000, what sorts of questions should you ask the provider before agreeing to go ahead?
- What are the advantages to a scheme of having a budget?
- Summarise the difficulties that a pensions manager might face when setting a budget at the start of the year.
- Explain to a chair of trustees what information about member charges and transaction costs have to be put into her annual chair statement.

Part 3

SELECTION OF INVESTMENT PROVIDERS





OVERVIEW

The main role of an investment manager is to invest the assets in accordance with the mandate agreed with the trustees. There are various possible approaches and the trustees will need to decide on which type they want, or more likely a combination. The main approaches are active and passive management.

There is a choice as to whether the investment manager retains the scheme's assets on a segregated basis or combines them with assets from other schemes on a 'pooled fund' basis.

Nowadays it is relatively uncommon to have a single investment manager, and instead trustees will use different managers who specialise in different asset classes or markets. While some managers will be employed directly by the trustees, others may be employed indirectly via one of the managers with a direct relationship ('manager of managers' or 'fund of funds').

The investment manager needs to fulfil various administrative functions agreed with the trustees to ensure the overall smooth running of the scheme (such as investing and disinvesting and rebalancing). Where there are multiple investment managers, the administrative arrangements need to be co-ordinated and responsibility for this must be determined.

Trustees need to consider carefully how to organise the investment management and this is the subject of Chapter 1.

In Chapter 2 we discuss how trustees should implement the agreed investment. This involves selecting the investment managers. Once in place, the investment arrangements should be regularly monitored, and if necessary amendments need to be made.

Finally, Chapter 3 considers the monitoring of an investment manager and the types of information required from them to assist the trustees in their governance functions.

CHAPTER 1

Approaches to Investment Management

INTRODUCTION

Trustees have a number of decisions to make regarding the investment management arrangements. Do they want the manager to be index-trackers or try to outperform the index? Do they want the manager to pool their assets with other schemes or manage them separately? Do they want a single manager or multiple managers who specialise in different types of investment? Finally, to what extent do they wish to delegate the investment decision making process?

1.1 ACTIVE AND PASSIVE MANAGEMENT

Management strategies can be split into two main approaches:

- active management: aims to outperform a particular market index or benchmark through manager skill.
- passive management: aims to match the returns of a particular market index or benchmark (also called index-tracking or indexing).

Active management stems from the belief that markets are not entirely efficient. Fund managers seek to exploit certain market irregularities or inefficiencies to achieve potentially higher returns. This is closely related to the investment term 'generating alpha'. Alpha is the additional return generated by manager skill as opposed to general market movements.

Passive management stems from the belief that markets are efficient or that it is difficult to beat the market. It may also be a preferred management strategy for those unwilling to take on the risks of active management.

Within the active approach, fund managers take an active role by deciding on which assets to buy and sell. They will take into account various factors affecting financial markets, such as economic and political issues, market and sector trends and company-specific features. Fund managers use various strategies in order to generate excess returns.

- **stock selection:** Fund managers select certain stocks in a particular market or sector, based on technical or fundamental analysis. The former analysis refers to past asset price patterns, while the latter looks at the asset's value in the context of underlying factors, such as the economy and company earnings potential.
- **Market timing:** Also called tactical asset allocation. Fund managers take advantage of short-term shifts in the market.

The passive approach means that fund managers try to mirror a particular market index or benchmark. This can be achieved in a number of ways.

- **Full index replication:** Fund managers buy the exact proportion of every constituent of the index. This means that the basic costs are substantial because many holdings must be maintained for an index such as the FTSE All-Share Index. On the other hand, after allowing for dealing and administration costs, the performance should mirror that of the index almost exactly.
- **optimisation:** Computer simulations are used to construct a portfolio with a limited number of shares chosen to reflect the characteristics of the index. Such simulations rely on historic share data, particularly share price correlations and volatilities, holding true in the future. Costs are lower than for full replication but performance will not coincide as precisely with that of the index. The expected variation above or below the index's performance is called the tracking error.
- **stratified sampling:** A random selection of stocks from within each market sector of the chosen index. The selection is made such that the sample has the same characteristics, such as yield and market weight per sector, as the chosen index. The number of stocks is lower than for full replication and hence costs are lower. Again, performance will not coincide with the index and the expected variation is referred to as the tracking error.
- **synthetic index replication:** Fund managers can use derivatives (which derive their value from the underlying index) to replicate an index, for example by combining a cash holding with a holding of futures in the particular index.

A comparison of the two approaches is summarised below.

`	ACTIVE APPROACH	PASSIVE APPROACH
Costs	Higher implementation and ongoing costs (expected to be more than offset by higher returns but not guaranteed)	Lower cost
Investment return objective	Aims to outperform a chosen index (but not guaranteed)	Aims to closely track a chosen index before deduction of fees
Ease of implementation and oversight	More difficult to select managers and implementation and monitor performance. Underperforming managers more likely, followed by changes	Relatively easy to select and monitor. Low risk of underperforming manager
Manager expertise	Takes advantage of expert/market Performance not reliant on the knowledge of fund managers. E.g. selecting investment skills of the fund manager good performing stocks or markets, or taking defensive measures if market is expected to weaken	Performance not reliant on the investment skills of the fund manager

Two terms in common usage for judging an active manager's performance (as well as that of individual investments) are Alpha and Beta:

- **Alpha:** A measure of investment performance compared to a benchmark. An active manager will be seeking to provide alpha through good stock selection in order to outperform the passive manager.
- **Beta:** A measure of volatility compared with the market. A manager who operates a portfolio with a low Beta would be expected to experience less asset volatility than one having a high Beta.

Typically, trustees will prefer an active manager to have high alpha and low beta.

A relatively recent trend is a move to what is known as smart beta. It is a form of passive management in that the investment is based on a set of rules. However, whereas passive management involves holding stocks weighted by market capitalisation (as represented by the index to be tracked), smart beta uses other criteria that aim to take advantage of perceived systematic biases or inefficiencies in the market. Smart beta is more expensive than passive but cheaper than active management.

1.2 SEGREGATED AND POOLED APPROACHES

A segregated approach involves the construction of a portfolio that is managed according to the client's specific requirements and needs, investing directly in various assets such as equities and bonds.

A pooled approach involves managing assets of a number of clients collectively according to the investment manager's stated philosophy.

In practice, a combination of segregated and pooled approaches is common.

One of the most important differences between the two approaches is the fee structure. The pooled fund is charged a flat fee for each individual underlying fund in which it invests, e.g. an annual fee of 0.4% of the total money invested for an equity fund and 0.15% for a bond fund. These fees are automatically subtracted from their funds.

Meanwhile, the management fees for a segregated fund can vary according to the size of the fund. There is likely to be a sliding scale of fees, e.g. a 0.3% annual fee for the first £30 million, 0.2% for the next £40 million, etc.

The investor in the segregated fund receives an invoice detailing what fees should be paid and there is an administrative cost for the service. Therefore, smaller schemes tend to benefit from the pooled approach, while the segregated approach is likely to be more advantageous for large pension schemes. In practice, for large schemes investing in a series of pooled funds, the fees may look identical to a segregated approach.

For pooled funds, investors automatically receive any income distributed from any of their holdings at the fixed dates (quarterly or annually). Depending on the class of shares that the investor holds, income can also be reinvested automatically as it arises (accumulation funds).

With segregated funds investors can specify how their funds should be managed, usually by identifying the benchmark and target asset allocation/returns. Some investors set restrictions such as not to invest in their own shares.

Types of Pooled Funds

Collective investment schemes (CIS) pool the resources of a number of investors and invest these in a specified type or range of assets. These schemes can have varying investment objectives, such as income generation or capital growth.

There are various types of investment vehicles:

- **unit trusts:** A unit trust is a trust set up as a pooled fund usually under the supervision of the FCA. Its portfolio of investments is divided into units to enable investors to buy into the trust or to sell an earlier investment. Unit trusts are "open ended" funds, which mean that the fund expands as more people invest and contracts as people remove their money.

  The price of a unit depends on the net asset value of the underlying assets. An increase in the value of the underlying assets leads to a rise in the price of a unit. Prices can be quoted one- way (the same price to buy or sell units) or two-way (a higher price to buy, or "the offer price" than to sell "the bid price"). The difference between the two is the "bid-offer spread". For one-way priced funds, charges are set out separately. For two-way priced funds, the charge is incorporated in the difference between the purchase price and the net asset value.

- **investment companies with variable capital (ICVC):** An investment company with variable capital (ICVC, formerly called an Open Ended Investment Company - OEIC) is a pooled fund that works in a similar way to a unit trust except it is structured as a limited company (plc) in which investors can buy and sell shares on an ongoing basis. An ICVC can be an 'umbrella' structure holding sub funds with different investment objectives. Every sub fund can offer different share classes with different fee structures for different types of client. ICVCs are open ended funds, which mean that the sub funds expand as more people invest and contracts as people remove their money.

  The price of a share depends on the value of the underlying assets. An increase in the value of the underlying assets leads to a rise in the price of a share.

  More recently unit trusts and ICVCs have increasingly moved towards a "single swinging price" structure, where there is no explicit bid-offer spread as set out above, but the price swings between bid and offer bases depending on flows in and out of the fund at the time of dealing.

- **investment trusts:** An investment trust is a pooled fund that is structured as a company and issues shares. These shares can be bought and sold on the London Stock Exchange. Unlike unit trusts and ICVCs, an investment trusts is a "closed ended" fund, which issues a fixed number of shares. The size of the fund does not expand or contract. In a closed end fund, the price of a share also depends on the value of the underlying assets. However, as only a limited number of shares are issued, the price of a share also depends on the demand for the fund's shares. This means the price of a share can move independently of the value of the underlying assets.

  In contrast to unit trusts and ICVCs, investment trusts can borrow money to invest. This is called gearing. Investment trusts don't fall under FSA restrictions on collective investment schemes. They are governed by the Companies Act and stock exchange listing requirements.

- **Managed funds:** A managed fund is an investment contract by means of which an insurance company offers participation in one or more pooled funds. Increasingly, insurance companies are setting up their investment services as separately identified asset management companies. Some also offer external fund links to investment funds run by other managers.

  Technically, a managed fund is an insurance policy run by a life company. It enjoys similar tax privileges to any other long-term pensions account within the life company. In practice, a managed fund is tax exempt and only pension schemes that are themselves exempt from capital gains tax may participate.

1.3 MANAGER STRUCTURES

Under a balanced management structure, one or more investment managers are allocated a proportion of a pension fund's assets to invest across a range of asset classes, as equities, bonds, property and cash. Tactical asset allocation decisions are delegated to the investment managers. These types of arrangement are now rare, for reasons explained below.

Under a specialist management structure, investment managers are delegated specific areas of responsibility. Trustees can, for instance, employ separate investment managers for UK equity, global equity, fixed income, property, private equity etc. This allows the trustees to make the strategic decision on how much of their pension scheme assets must be invested in each asset class. The move to using different mangers for different portions of an overall scheme also reflects the reality that a single fund management company is unlikely to have market leading capabilities in all asset classes.

However, increasing the number of specialist managers generally results in higher investment management costs overall, and significant increases in complexity, accountability and governance requirements.

The move towards specialist management structures has led to the appointment of multiple managers by pension schemes to obtain the skills of the 'best' specialist managers. Separate active mandates for specific asset classes may be coupled with a core passive manager. The single manager appointment (other than for small schemes) is now rare.

1.3.1 Multi Manager Funds

Trustees' responsibility for diversification and to act in the best interests of beneficiaries implies that trustees should use the 'best of class' managers in each area and mix them appropriately to increase outperformance opportunities. This has led to the increased use of multi manager funds.

There are two distinct approaches to multi manager funds.

- **Manager of Managers (MoM):** Refers to the appointment of a few select managers, who are then given specific mandates to manage the investment in a single fund. The role of the MoM is to select the specialist managers, monitor their performance and to alter the composition of the management team to adapt to market conditions or fund performance.
- **Fund of Funds (FoF):** Describes the process whereby a manager builds up a portfolio that invests in funds that are run by a number of other managers. The fund of funds itself is generally structured as an ICVC or as an investment trust.

Multi manager funds have a number of attractions:

- **Fund or manager selection expertise:** The key attraction of multi manager funds is the expertise that they bring to manager selection. For a fund of funds, the multi manager selection process uses a number of analytical tools to narrow down the fund universe to a more manageable level. The multi manager is likely to conduct a rigorous interview process with each of the fund managers that fit the investment criteria and these meetings will often reveal a good deal more than quantitative analysis.

  Importantly, this is also an ongoing process, as many factors can change in the management of a mutual fund, of which a direct investor may not be aware. Meanwhile, some fund managers perform well in certain investment backdrops but not others leading to periods of underperformance. The fund of funds manager can position himself for changing market dynamics by altering his portfolio accordingly.
- **Diversification:** Investors in a multi manager fund also benefit from increased diversification. Traditional unit trusts provide an extra layer of diversification compared to investing directly in a few individual stocks. Multi manager takes this process a step further by creating blends of best of breed fund managers. A selection of managers with different investment approaches can reduce the risk in a portfolio without eroding the alpha they provide. Alpha is the standard measure of a fund manager's ability to add value.

  The diversification aspect of a multi manager strategy and the manager's ability to tilt the fund toward certain investment styles is of even greater importance in multi region and/or multi asset class portfolios. Here the manager can reduce exposure to assets classes or regions of the world that have poor prospects; and skew the fund towards areas with better fundamentals.
- **Access:** Another attraction of the multi manager approach is that it allows even small pension schemes access to certain funds and investment expertise that would not normally be available. This is due to the minimum amounts of investment required by some investment vehicles or simply because they are not widely known in the wider market.

  The main criticism levelled at multi manager funds is that they have higher charges. Single manager mutual funds charge fees to investors and so do multi managers' funds. Therefore, it would follow that investing in a multi manager fund results in two layers of charges. This is largely true but, given that one of the benefits of investing in a multi manager fund is economies of scale, such funds are able to negotiate very attractive rates, leading some to have TERs (total expense ratios) similar to standard pooled funds.

1.3.2 In House Management

Accurate and timely information is essential for successful fund management. The necessary financial data can be purchased from any number of market related sources, but adequate IT and financial systems are required to access it. The costs of these systems and services are significant but manageable.

The opportunity to gain professional views on time sensitive issues from those closest to the activity in the markets often depends on the buying power of the organisation. The greater the volume of assets under management, the greater the buying power and the better the terms likely to be obtained when agreeing a deal. Consequently, there are serious disadvantages for organisations managing small amounts of money, in the form of low priority of response from market participants and less attractive price quotations.

Bearing in mind the concentration of power in the hands of a few large institutions, it is difficult to justify the management of pension scheme assets in house unless they exceed £500 million. There is no practical reason stopping schemes with assets smaller than this from being managed in-house but the financial arguments are stacked against them. It is not surprising, therefore, to see that only a small number of the largest schemes manage their assets themselves.

Employers or trustees who have decided to manage their pension assets 'in house' face the same issues as an investment organisation offering investment management services, except that they are involved with only one (tied) client.

1.3.3 Delegation And Fiduciary Management

Pension schemes (especially small to medium sized schemes) struggle to respond quickly to changes in investment markets. Delegated management allows trustees to outsource some parts of the investment decision-making process. The responsibility for setting the risk/return budget will always be retained by the trustees but beyond that most investment duties can be delegated.

Many of the traditional benefit consultancies now offer delegated management, also referred to as implemented consulting. In adopting a delegated management model, the investment consultant will provide clearer, real-time investment recommendations to the trustees than under the traditional model. The responsibility for the decision-making remains with the trustees. The presentation of advice from the investment consultant and the use of an effective decision making process by the trustees should mean that the scheme's assets are managed in a more dynamic, efficient and appropriate manner.

Fiduciary management is an extended version of delegated management. It involves the appointment of a fiduciary manager who becomes accountable for implementation of the overall investment strategy adopted by the trustees. All of the day-to-day investment decision-making is delegated within pre-agreed guidelines. This allows the trustees to focus on other areas as well as ensuring that investment decisions are extremely dynamic.

Summary

A pooled investment approach involves investing in existing funds managed by an investment management firm, usually combining several funds for diversification purposes.

A segregated investment approach involves constructing a portfolio that is managed according to the client's specific requirements and needs, investing directly in various assets such as equities and bonds, although it may also invest in existing funds in order to achieve greater diversification.

An active management strategy aims to outperform a particular market index or benchmark through manager skill.

A passive management strategy aims to match the returns of a particular market index or benchmark (also called index tracking or indexing).

Under a balanced management structure, one or more investment managers are allocated (a proportion of) a pension fund's assets to invest across a range of asset classes, such as equities, bonds, property and cash.

Under a specialist management structure, investment managers are delegated specific areas of responsibility. The move towards specialist management structures has led to the appointment of multiple managers by pension schemes to obtain the skills of the 'best' specialist managers.

Trustees' responsibility for diversification and to act in the best interests of beneficiaries implies that trustees should use the 'best in class' managers in each area and mix them appropriately to increase out performance opportunities. This has led to the increased use of multi manager funds.

In a manager of managers (MoM) fund, the MoM appoints a few select managers, who are then given specific mandates to manage the investment in a single fund. In a fund of funds (FoF), a manager builds up a portfolio that invests in funds that are run by a number of other managers.

Delegated management allows trustees to outsource some parts of the investment decision-making process. Assets are managed in a much more dynamic fashion as the investment consultant takes a more directive role. Full delegation, where the outsourcing of all day-to-day investment decisions to a specialist fiduciary manager, is also gaining popularity.

Self Test Questions

- What are the key differences between unit trusts and investment companies with variable capital?
- Describe the four types of passive investment strategies.
- What are the main advantages of using an active investment strategy?
- What are the benefits of multi manager funds?
- Describe delegated management and fiduciary management

CHAPTER 2

Selecting Monitoring and Changing Investment Managers

INTRODUCTION

Once trustees have decided upon an investment strategy, they should select an investment manager or managers to invest the funds on their behalf. The Pensions Act 1995 requires trustees to take professional advice on the selection of investment managers. In addition, the Myners Review proposed that trustees should be prepared to pay sufficient fees for investment advice to attract a broad range of potential investment managers. Trustees normally employ an adviser who is able to research suitable investment managers. The adviser will usually provide a 'long list' and then provide reasons for reducing it to a 'short list', from which the trustees may select two or three managers to interview. At these interviews, trustees will meet representatives from the investment manager.

In the following Chapter, we look at the responsibilities of pension scheme trustees during the manager selection process. In addition to choosing the manager, trustees are responsible for negotiating fee structures, setting performance targets and ensuring that a scheme's assets are held securely (custody of assets).These details will be laid out in a contract between the trustees and the asset manager, called the Investment Management Agreement (IMA)

We also consider the issues involved when trustees decide to move the management of a portfolio to a different manager, known as 'transition management'. Finally, in the last subsection we look at the role of investment banks in the investment management process.

2.1 MANAGER SELECTION PROCESS

The factors that trustees need to consider when selecting a manager will be largely shaped by the strategy they have chosen. Nonetheless, there are a number of general factors that can be taken into account. With the focus on investment strategies to manage a global economy undergoing climate change manager selection is now also requiring a demonstration of what practical measures the investment manager is putting into place to support a scheme's strategy towards net zero investments and governance disclosures for the annual Implementation Statement (and TCFD reporting for those schemes required by the Pension Schemes Act 2021). Increasingly fund managers are offering greater transparency over their work in assessing to what extent investments have ESG impacts.

2.1.1 The Business

The trustees will want to ensure that the investment manager's business is strong and will remain so for the foreseeable future. Pension investment is for the long term and frequent changes in investment manager can be expensive in terms of fees and transition costs. For example, is the investment manager part of a larger organisation? This could be an advantage as the larger parent can provide financial and other support but could also be a disadvantage if the investment management business is not core to the parent; it may make a strategic decision to sell it or fail to support it sufficiently. Growth or loss of clients is also a significant indicator, but again trustees should be wary of a manager who appears to be taking on substantial new business and question whether the investment process is scalable and whether the manager has the business and investment infrastructure to cope.

2.1.2 Investment Team And Structure

Are the people of good quality and experienced in the relevant area of investment? How stable is the team? The manager could be asked for staff turnover data, for example. How is the team rewarded for performance? What incentive plans are in place and do they motivate appropriately and act as a retention tool?

2.1.3 Investment Philosophy And Process

Most trustees will look to their advisers for guidance on this area. It is important to establish what drives the manager's process, for example, whether it is based on an individual manager's stock selection ideas or whether it is driven by a house theme, such as growth or value stocks. Trustees should consider the extent to which decisions are driven by a team or by individuals. Perhaps more importantly the trustees should check whether the style they seek is appropriate for the manager.

2.1.4 Management

Any active investment manager must take risks. Risk is usually measured as the risk the manager takes relative to the benchmark (e.g. the FTSE All Share index) set. Risk can take many forms, from specific matters affecting one stock (stock specific risk), to the risk that the overall portfolio might be exposed to a particular factor, e.g. the investments are vulnerable to rises in interest rate rises or oil price rises (factor risk). The trustees will therefore want to satisfy themselves that the manager has developed risk controls, both through systems that calculate risk but also management structures that ensure accountability of individual managers and oversight of portfolio construction.

2.1.5 Systems

Quality and regularly updated systems are increasingly important, in order to effectively produce and analyse investment data, and to identify charges being made for investment. Trustees should be aware of the manager's commitment to this area.

2.1.6 Performance

Most trustees will know, or will be quickly told, that past performance is not a guide to future performance.

This is true but the reasons for past performance might be helpful in analysing how a fund manager might perform in the future. For example, if a manager had good performance in the previous three years the reasons for this can be analysed, e.g. was it because of one individual who was very good at picking individual stocks or was it because of a systematic approach that has been particularly successful in identifying good and bad sectors? More importantly, are the people and the process in place today likely to be able to sustain or improve on that performance?

2.1.7 Client Service

Trustees and their investment advisers should receive reports and other information from the fund managers in an accurate and timely manner. Trustees should be able to expect open, transparent, comprehensible and timely communication from their investment managers, together with attendance at trustee meetings when required.

2.1.8 Fees

Other than perhaps the area of passive management, the relative fees of managers should not drive the trustees' selection of a manager. The prospects of relative performance, as well as client servicing considerations, should always override considerations on fees.

As a general rule, the level of any fee will be driven by:

- The level of fees typical for that product in the market - peer group pricing
- The type of management style – passive is cheaper than active
- The size of fund - larger investments will get a lower percentage fee overall
- Whether the manager is looking to 'buy' businesses.

Fees may also be linked to performance. For example, having been set a performance target, a manager may charge an additional fee for any performance in excess of this target. Such performance related fees should be designed to encourage and reward outperformance but should not be so tempting as to encourage risky investment to meet the outperformance targets.

2.1.9 ESG - Socially Responsible Investments

ESG (Environmental, Social and Governance) is a term used to demonstrate that the investments being made are sustainable, ethical and strong on corporate governance. The fund manager would be expected to show trustees how the asset classes being invested in could perform well against:

- Environment risks arising from climate changes
- Social risks from poor human rights and negligent care of workers in the industry being invested in
- Governance risks addressed with a diversity of Board directors, brand resilience and accountability to stakeholders for executive compensation and other UK Corporate Code matters.

In September 2019 TPR issued 'Investment guidance for defined benefit pension schemes' that stated trustee should 'Take environmental, social and governance (ESG) factors into account if you believe they're financially significant'.

DC funds and master trusts also have a requirement to offer funds that meet the needs of their membership. This includes ESG funds and Shariah-compliant funds which are governed by the requirements of Muslim Shariah law and principles for socially responsible investing. TPR also gives information on the climate challenge through its blog published in the media hub section of the TPR website.

The Pension Schemes Act 2021 (PSA 2021) which became law in February 2021 has issued regulations already regarding climate change disclosures for qualifying schemes. Details of these are given in this manual Part 1 Chapter 2 Good Governance 2.4.4 Impact of the Pension Schemes Act 2021.

The issue of how to invest in response to climate change is now becoming the major factor in driving investment strategy and governance with a number of scientific reports demanding a change in behaviours. The UN report by the IPCC (Intergovernmental Panel on Climate Change) in August 2021 reviewing over 14,000 scientific papers stated that emissions of greenhouse gases from human activities are responsible for approximately 1.1 degree Celsius of warming since 1850-1900 and found that averaged over the next 20 years, global temperature is expected to reach or exceed 1.5 degree Celsius of warming. This is turn means increased heat waves, longer warm seasons and shorter seasons. At 2.0 degree Celsius of global warming, heat extremes would more often reach critical thresholds for agriculture and health.

The climate change context with its effect on health, infrastructure, economy and political risk is making the investment of pensions increasingly more complex with the risk of 'stranded assets' from a sharp decline in fossil-based industries, and an economy where there are no global emissions of CO2 ('net zero'). The IPCC (ipcc.ch) publishes working group papers regularly such as The IPCC Sixth Assessment Report 'Climate Change 2022:Mitigation of Climate Change.' (https://www.ipcc.ch/report/ar6/wg3/) and Climate Change 2023: Synthesis Report.

(https://www.ipcc.ch/report/ar6/syr/downloads/report/IPCC_AR6_SYR_SPM.pdf).

In July 2021 14 pension fund chairs signed the 'A4S Net Zero Statement of Support'. The chairs signing the statement drawn up by The Prince's Accounting for Sustainability Project ('A4S') represented £268billion assets under management and stated:

"The Statement of Support commits us, within 12 months of signing, to:

- Committing to set net zero targets to align our investment portfolios with a 1.5˚C pathway.
- Ensuring our direct service providers support this ambition.
- Being an active shareholder across all relevant asset classes we invest in.
- Collaborating with our peers to innovate ways to bring influence to bear in the interest of our members.
- Attempting to understand climate risk in a holistic manner and to manage these risk factors within our investment portfolios, including physical and transition risks." (**https://www.accountingforsustainability.org/net-zero-pension-statement.html**)

A4S have also produced the 'ESG maturity map: Example behaviours for pension trustees' as a guide to help pension trustees assess what their scheme is doing to embed ESG considerations into pension schemes' investment decisions, reporting and engagement across the investment chain (**https://www.accountingforsustainability.org/en/activities/projects/pensions-toolkit/pensions-maturity-map.html**)

2.1.10 Climate Change Governance and Disclosure Requirements

The Pension Schemes Act 2021 introduced mandatory climate-related governance and disclosure duties for trustees of qualifying schemes. These duties were originally set out in the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021, requiring trustees to adopt governance processes aligned with the TCFD (Task Force on Climate-related Financial Disclosures) framework. Since then, the regulatory landscape has evolved, and several changes have been made to strengthen climate-related governance, reporting and risk management.

Current regulatory basis:

- Pension Schemes Act 2021 (climate governance duties)
- Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (as amended)
- Occupational Pension Schemes (Governance) (Amendment) Regulations 2024
- TPR Single Code of Practice (2024) – Climate Change, Investment Governance, Risk Management, Reporting and Disclosure

Extract from updated governance expectations (Single Code 2024):

- Trustees must integrate climate-related risks and opportunities into their overall governance and risk-management framework, including scenario analysis, metrics and targets.
- Climate-related performance indicators should be reviewed regularly, with outcomes recorded and actions tracked.
- Trustees must ensure that service providers and advisers supplying climate-related data, analytics or modelling are subject to appropriate oversight, including KPIs and SLAs where relevant.
- Climate-related disclosures must be produced annually and published in accordance with statutory reporting requirements, including any updates introduced by the 2024 regulations.

Commercial Aspects of Operating a Workplace Pension Scheme

By having meaningful climate-related performance measures you:

- Know what you are aiming for — the climate-related objectives for the scheme, which should be defined in your investment and risk-management framework.
- Know what you must do to meet your objectives — you understand the climate-related risks affecting the scheme, the data required to assess those risks, and how your advisers and asset managers support delivery of those objectives.
- Know how to measure progress towards your objectives — trustees must ensure that providers can supply reliable climate-related metrics, including emissions data, scenario analysis outputs and transition-risk indicators.
- Can detect climate-related governance or data problems and remedy them.

Implementing climate-related measures has an associated cost, so it is important to agree at the outset what the critical success factors might be. These might include:

- Focusing on outcomes that support long-term member interests, rather than simply reporting outputs.
- Defining and using climate-related measures that evolve over time as data quality improves.
- Measuring both effectiveness (managing climate risks appropriately) and efficiency (obtaining reliable data and analysis in a cost-effective way).

In setting up the climate-related performance measurement system trustees can use these evaluation criteria for measures and metrics. These include:

- Measuring the right climate-related risks.
- Having the right climate-related metrics.
- Using the metrics in the right ways.

Any climate-related measurement system must drive the right behaviours. For example, if the only measure focuses on emissions reduction, providers may prioritise short-term portfolio changes rather than long-term stewardship or engagement. The same applies to any climate-related penalties, which should be used to restore performance to desired levels, not to punish providers.

It is often forgotten that there should be both internal and external climate-related measures. Examples of external measures include:

- Emissions metrics (Scope 1–3 where available)
- Climate-related scenario analysis outcomes
- Regulatory compliance with climate-related reporting
- Stewardship and engagement outcomes
- Transition-risk indicators
- Physical-risk indicators

These are also valuable internal measures, but a management team is likely to require additional measures such as:

- Data quality and completeness
- Efficiency of climate-related data collection
- Provider performance in delivering climate-related analytics
- Levels of rework or data correction
- Staff capability and training in climate-related governance

2.2 IMPLEMENTING A CHANGE IN MANAGERS

Once a manager has been chosen, the trustees will need to establish an Investment Management Agreement (IMA); agree the manager's performance targets; and possibly establish socially responsible criteria (the International Organisation of Pension Supervisors (IOPS) has published supervisory non-binding guidelines (October 2019) on the integration, where proportionate, of Environmental, Social and Governance factors (ESG) into the investment and risk management of pension funds). These are now a mandatory legal duty under the 2024 General Code of Practice..

Trustees also need to select a custodian that is secure and appropriate to the size and number of transactions likely to occur.

2.2.1 Investment Management Agreement

The IMA is the contract between the trustees and the investment manager. In drawing up an IMA, trustees will usually consult their investment advisers and, if required, legal advisers.

The IMA will set out specific investment guidelines agreed upon by the investment manager and trustees. The trustees may also wish to clarify the details of their statement of investment principles with the fund manager, so these principles can be accommodated in the exercise of the investment power.

A typical IMA will normally include the following sections:

- **Investment management:** This section will normally include details of the authorisation procedures of the client and any restrictions or limitations that trustees wish to impose on the management of the fund. For example, trustees may limit the investment in any one stock to say 5% of the overall fund value, or prohibit the investment in certain types of asset.
- **Securities lending, borrowing and overdrafts:** This section will normally state whether stock lending is permitted and if so, any restrictions on the terms, size of deals etc. Stock lending involves lending shares for a short period of time to a third party, for a fee, so they can complete a deal in the same shares.
- **Delegation and use of agents:** The IMA will usually permit the fund manager to delegate or appoint sub agents but the fund manager should remain liable to the trustees for their acts or defaults.
- **Material interests:** This section will address any potential conflicts of interest.
- **Dealing and derivatives**
- **Voting and corporate actions**
- **Fees and expenses**
- **Confidentiality and data protection**
- **Risk Management**

The IMA should also cover custody and title of assets, although in certain circumstances, custody of assets may be subject to a separate agreement if the trustees choose to use a third party for such services. Where trustees appoint a global custodian to hold all its assets, they will draw up a separate global custody agreement.

2.2.2 Performance Targets

- relative return performance targets: Traditionally, investment mandates targeted outperformance of a relevant peer group. However, increasingly, the performance of other pension schemes or investment managers is not a meaningful or relevant benchmark as schemes and investment approaches have become less homogeneous and comparable. The Myners Review recommended that trustees move away from peer group benchmarks to ones that are specifically tailored for their own fund. Targets are, therefore, more commonly expressed as a percentage above a specific market index benchmark or a scheme specific composite target benchmark. For example, a UK equity fund may be set a target to outperform the FTSE All-Share index by 1% over rolling three-year periods. This relative return approach means investors may experience either positive or negative returns, depending on the direction of the markets.
- **absolute return performance targets:** Absolute return benchmarks, meanwhile, set a positive return target to be achieved in all market conditions. The target is usually to outperform the cash rate by,say,2-4% p.a. for growth- oriented assets. The cash benchmark in this case is usually measured by LIBID, the wholesale deposit rate.
- **performance targets linked to liabilities:** Given the increased focus on pension liabilities, performance targets can also be set against a scheme's liabilities, as is done under liability driven investment. In a fully matched strategy, the target is set in line with the scheme's liabilities. In a strategy containing a core matched portfolio and a return-seeking component, the target can be set to exceed the liability benchmark by a certain percentage.

2.2.3 custody of assets

Trustees are required to ensure that a scheme's assets are held securely. Assets may be held in the name of the trustees directly or, as is more commonly the case, in the name of a nominee company but specifically designated to the trustees. The latter is preferable since it makes administration far simpler, with the nominee company retaining share certificates and receiving dividends, which would otherwise need to be dealt with by the trustees. It also reduces the amount of paperwork required by the trustees who otherwise would have to complete stock transfer forms and return share certificates for each sale or partial sale of shares. The trustees should ensure that the nominee company is capable of dealing with assets in this way and is suitable for the size and number of transactions likely to occur.

The Role of the Custodian

A custodian holds investments securely on behalf of the pension scheme and is able to account independently for any financial transactions. Custodians often offer a range of other services such as:

- Income collection – collecting dividends and coupons payments due on stocks and shares
- Tax recovery – recovery of withholding tax which can be reclaimed
- Cash management – management of the cash account
- Settlement of securities – administration of the actual exchange of cash for securities when a security is traded
- Foreign exchange – settling foreign exchange deals
- Stock lending – arranging for stock lending deals
- Voting rights – exercise voting rights on behalf of the manager or trustees.

When appointing a custodian, trustees should consider the following issues:

- The custodian's insurance arrangements
- The custodian's arrangements with the fund manager
- The custodian's arrangements with sub-custodians, where relevant.

Larger schemes may appoint a global custodian, such as a bank, to hold all their assets regardless of which investment manager manages them.

The use of pooled funds eliminates the need for a separate custodianship arrangement.

Details of custody and title of assets are normally set out in a custody agreement. However, In the case of pooled funds, there will be a fund prospectus setting out the terms of the fund, or a policy document in the case of a pooled pension fund contract.

2.2.4 Trustee Authorities And Cash Flow Control

The trustees, when appointing an investment manager, usually give full authority to the investment manager to make whatever investments the manager deems appropriate, within the terms and conditions of the IMA. This reduces the need for the trustee to give their authority for each investment to be made. However, the trustees need to document quite carefully who is entitled to give authority to the managers and to ensure that such authority complies with the requirements of the Trust Deed.

Investment managers usually hold cash, from time to time, to ensure that they can make investments at the most appropriate time and you would not normally expect them to have to seek approval from the trustees in these circumstances. New money in the form of contributions would need to be passed to the investment managers, which they would then hold in their client cash account until such time as appropriate investments become available. The managers would also hold dividend income and proceeds from sales in a similar manner. The operation of such bank accounts will be detailed in the IMA.

2.2.5 Administration

For the investment manager, administration of a pension scheme portfolio involves:

- Investment record keeping
- Informing the trustees or nominee company of investment transactions through the sending of a trade advice, trade notification or contract note
- Daily stock reconciliation of records of a portfolio's holdings with those held by the custodian
- Reporting, valuation statements and performance analysis

2.2.6 Transition Management

Transition management refers to the management of the transfer of a pension scheme's portfolio to a new investment manager. This will require the negotiation of an IMA with the new manager, including details on investment restrictions and guidelines, reporting requirements, the fee structure etc. The trustees may also choose to change the custodian in a transition to a new manager, requiring new custody accounts to be set up.

Depending on the type of portfolio the pension scheme holds (pooled or segregated) and the investment strategy to be adopted by the new manager, the transfer may require the sale of all or some of the portfolio's assets. The new investment manager should aim to effect the transition at the lowest possible cost to the pension scheme. The following costs may be taken into account:

- Stamp duties
- Commissions: good market relationships and program trading can reduce this cost
- Broker's bid and ask spread: the market impact and timing of executing trades

The trustees' investment consultant would typically advise on and manage asset transitions, although this may be delegated to a specialist transition manager.

2.2.7 Use Of Investment Banks

So far, we have mainly looked at the relationship between pension scheme trustees and investment managers. During the implementation and design of a scheme's investment strategy, investment managers will often make use of investment banks, particularly as a counterparty for swap trades. Swaps are widely used in asset/liability matching strategies and can often be very significant in size. Strong counterparty relationships between an investment manager and the investment banks with which it transacts can help ensure that a pension fund achieves the most favourable trade execution terms available. Investment managers that have access to a wide range of counterparties may be able to access better terms than those who are tied to just one investment bank.

In addition to this counterparty relationship between a pension scheme and an investment bank, the sponsoring company of a pension scheme will often have separate relationships with investment banks through its treasury department. Investment banks will advise the sponsoring company on issues regarding its corporate assets.



2.3 RISK CONSIDERATIONS WHEN SELECTING INVESTMENT MANAGERS

When trustees implement a change of investment manager risk should be one of their key considerations. Areas for the trustees to consider include:

- Risk of the manager failing to deliver its expected level of performance.
- Risk of structural changes within the investment manager (e.g. loss of a senior staff member or team, or lack of investment in the relevant area).
- Risk attached to the level of hedging provided by the scheme's managers (not enough hedging, or over- hedging).
- Where hedging is used by the manager, risks attached to leverage (e.g. possible future cash calls).
- Risk that the legal terms in the investment documents could prove restrictive for the trustees (e.g. "gating" provisions which might restrict the trustees' ability to redeem their investment).
- Risks attached to investment in more bespoke investment vehicles (e.g. private equity funds, or unregulated funds based in territories such as the Cayman Islands).
- Risks attached to the wider investment strategy, e.g. an emphasis on return-seeking investments without an appropriate level of downside protection.

Trustees can mitigate their own risks on this area in a number of ways. For example, these include:

1. Taking advice from a regulated investment adviser (which they are legally required to do under the Pensions Act 1995, as noted above).
2. Making sure they understand what that investment adviser (and, where appropriate, investment manager) are telling them, and not holding back from asking questions where the explanations given are unclear or overly technical.
3. Ensuring the reasons for their investment decisions are clearly recorded in trustee minutes.
4. Treating investment decisions as the responsibility of the full trustee board, even if much of the detailed work is carried out by a sub-committee.
5. Where possible, looking to share experience and views with other trustee boards facing similar challenges (e.g. through industry forums or appointment of a professional trustee).
6. Keeping up a close dialogue with the scheme's sponsoring employer about investment decisions, unless the employer is unwilling to do this.
7. Arranging a legal review of the documents for every new investment, even if the investment is in a pooled fund and the documents are presented by the manager as non-negotiable.
8. Being clear about the time frame for appointing each new manager, which means ensuring that the appointment is not rushed unnecessarily, but also that delays in the appointment process do not cause the switch to be executed at an unfavourable time.

These are important steps and trustees should pay close attention to them. For larger schemes that frequently appoint new investment managers, trustees should consider putting in place a defined process that they follow for each new appointment to ensure the risks are minimised.

Summary

There are a number of factors that trustees should consider when selecting an investment manager including:

- The strength of the manager's business
- Its investment team and structure
- The strength of the manager's investment process and risk controls
- Performance track record
- Client service and administration
- Fees – fees charged by investment managers are driven by factors including the type of management style and the size of the scheme. Fees may also be linked to performance
- Where managers plan to make use of derivatives, such as swaps, trustees should consider their relationship to the investment bank(s) with which it transacts
- Transition management process – transferring a scheme's assets to a new investment manager requires effective transition management to minimise costs
- ESG audit trail – investment manager resources to identify and report to the trustees about how resilient assets invested are against environmental, social and governance risks

Self Test Questions

- List the main factors that should be taken into account when selecting an investment manager.
- What should an Investment Management Agreement cover?
- Outline some of the ways in which performance targets may be set.

CHAPTER 3

Monitoring Manager Performance

INTRODUCTION

In this Chapter we consider the monitoring of an investment manager and the types of information required from them to assist the trustees in their governance functions. Investment managers will provide trustees (or investment committees) with regular (usually quarterly) reports, containing information on the portfolio's valuation, activity (acquisitions and disposals) and performance. Investment managers will also be expected to provide information to the scheme's custodian. The trustees might also ask the fund manager to provide the investment report section of the trustees' annual report. In addition to regular reports, trustees hold regular meetings with investment managers where these issues are discussed.



3.1 PORTFOLIO VALUATIONS

Investment managers will provide trustees, or their investment committee, with a monthly or quarterly portfolio valuation. This will include the following:

- A summary portfolio valuation, confirming the book value and market value of the total portfolio held and its main constituents, and a detailed portfolio valuation containing every individual security. The valuation gives an overview of the portfolio at the end of the period under review.
- Details on investment activity over the period, with a summary and details on acquisitions and disposals of securities.
- As the securities held in the portfolio may have generated coupon payments or dividends over the period, the report will also include a section on income receipts.

3.2 PERFORMANCE REPORTING

Investment performance measurement is often the main area of monitoring. The nature of the mandate given to an investment manager will determine the way and degree to which they are assessed. A passive manager is employed to track an index while an active manager is usually employed to beat an index.

The purpose of performance measurement is to establish, as accurately as possible, the rate of return earned on the assets of the portfolio. This is the absolute return and can be given net or gross of the manager's fees. This will then be compared to the benchmark set by the trustees for the investment manager, for example, the return of the FTSE All-Share index for UK equities or the FTSE British Government All Stocks index for UK gilts. Investment managers provide trustees or their administrators with a monthly or quarterly performance report.

The calculated rate of return can be divided into its constituent parts in several different ways to help understand how the manager achieved it. This is called performance attribution. For example, an examination of the impact of 'asset allocation' will show the impact of losses or gains stemming from being overweight or underweight in a certain asset class, sector or region within an asset class. It is usual to combine this with an examination of the impact of 'stock selection'. Stock selection establishes the extent to which a manager chose shares within an asset class, sector or region that performed better or worse than an index typical of that market.

In a bond portfolio, performance attribution can examine the impact of a manager's decision to hold overweight or underweight exposure to gilts compared to corporate bonds or to hold an increased or decreased exposure to the riskier or less risky segments of the corporate bond market. For commercial property, the impact of the balance between the three principal sectors of offices, shops and industrials can be considered.

The managers appointed should provide trustees with regular investment reports, including:

- Quarterly and annual performance reports
- Records of the specific investments, including quantity held, both historic and current values, plus information for performance evaluation
- Commitments entered into for the future
- Record of income received from different sources, i.e. dividends, interest, bonuses etc.
- Record of historical outgoings
- Record of 'capital' events, e.g. rights, calls, mergers, stock splits, etc.
- Continuing forecast of income/outgo, i.e. cash flow projections
- Record of expenses and transaction costs incurred
- Record of corporate governance and voting activity.

Trustees may also use reports from an investment performance monitoring service.

3.3 PEER GROUP COMPARISONS

Performance details can be obtained for the 'universe' of all eligible pension schemes, both overall and broken down by asset category. This allows each pension scheme to see how it has performed compared to other schemes. Two numbers are normally considered: percentile ranking, and the difference between fund performance and median performance. For instance, a UK equity manager might have beaten the median manager by 3.2% in a particular quarter (+6.2% vs +3.0%), and been ranked in the 20th percentile, i.e. he beat 80% of the other UK equity managers in that particular universe. Similar figures are provided for each asset class, and for the fund overall.

However, some performance comparisons can be misleading. Schemes of different maturity should have different investment policies, and it makes no sense to compare the results of a fund with high equity content to that of a fund with a significant element of gilts.

Within a single asset class, such as European equities, peer group comparisons can be valid. Again, however, it is not always clear that managers are pursuing the same goals in a particular region. For example, some managers regard Australia as a 'developed' market which has little in common with the tiger economies of Asia, and so either exclude it from their Pacific Rim portfolios or give it only a minimal weighting. Others point out that by market capitalisation it is by far the largest market in the region outside Japan and construct their portfolios accordingly.

3.4 COMPARISON AGAINST A MARKET INDEX

Performance of a pension fund can also be measured against a relevant market index. Indices have the advantage of being available on a timely basis, their construction is transparent and their performance is unambiguous. Nevertheless, care has to be taken when selecting an index as benchmark for a manager.

Firstly, the benchmark must be appropriate. Should a UK pension fund invest only in the top 100 companies, which is what would be implied by a FTSE 100 benchmark or should it also look at mid and small-cap companies and choose the FTSE All-Share index?

Secondly, the benchmark represents a neutral position for the manager. However, an index may be dominated by one particular market, sector or company and pension fund trustees need to make sure that this is acceptable.

Thirdly, the index must be practical; some Asian indices include stocks which overseas investors are not allowed to buy.

If a pension fund is allocated to a balanced manager, the benchmark will be the aggregate of its constituents, for instance:

ASSET CLASS	BENCHMARK %	INDEX
UK Equities	35	FTSE All-Share
Overseas Equities	25	FTSE All-World (ex-UK)
Corporate Bonds	10	Sterling Non-Gilts
UK Gilts	28	FTSE British Government > 15 years`
Cash	2	LIBID 7 day

The overall fund benchmark return will be made up of the relative percentage of each of the above.

Summary

Trustees are required to monitor an appointed investment manager against their original selection criteria and performance objectives on an ongoing basis. The trustees should consider the manager in light of any changes they make to their investment strategy to ensure they continue to meet the trustees' objectives.

To assist in this process, investment managers are required to provide trustees with regular investment reports containing information on the portfolio's valuation, activity and performance. Performance should be measured and assessed in relation to the targets originally set by the trustees.

Self Test Questions

- List the key points that an investment manager's report should cover.
- Outline the ways in which a manager's performance can be measured.

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