



# PENSIONS ALERT: NEW CODE AND ACCOMPANYING GUIDANCE - MONEY PURCHASE BENEFITS

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A new version of the Pensions Regulator's code of practice about the governance and administration of schemes providing money purchase benefits came into force on 28 July 2016 setting out the standards of conduct and practice that the Regulator expects trustees to meet in complying with their duties in legislation. Following a consultation issued in April 2016, the final versions of accompanying guidance documents were also published on 28 July providing practical information, examples of approaches and factors to consider.

In this Pensions Alert we provide trustees with an overview of some of the key points to note from these documents and the action points they should consider taking. In particular, we focus on some of the areas which have changed or been added since the previous version of the code was published in 2013.

## RELEVANT SCHEMES

The code and guidance apply to trustee boards of all occupational trust-based schemes with two or more members which offer money purchase benefits. This means that as well as applying to schemes which are purely defined contribution (DC) and the DC section of schemes which have both defined benefit (DB) and DC benefit sections, the documents also apply to DC AVCs within occupational DB schemes, DC benefits with a DB underpin, and DC underpin benefits where these are provided by a scheme, insofar as the relevant legislation applies to them.

In particular, it should be noted that not all of the legal requirements reflected in the code apply to schemes in which the only DC benefits are AVCs (for example, the new DC statutory governance standards). However, the Regulator states that trustees should consider the risks to members in the context of the significance of the value of AVCs relative to members' overall benefits in the scheme (as opposed to the size of the AVC arrangement relative to the scheme overall) and, where the legal requirements do apply to AVCs, take a proportionate

approach to meeting the standards in the code. Even if the legal requirements do not apply, in our view it would still be good practice for trustees to consider whether it would be beneficial and proportionate to apply an aspect of the code to the AVC arrangements.

## BACKGROUND AND OVERVIEW

The Regulator first introduced a DC code of practice in November 2013 which was underpinned by a number of DC quality features that the Regulator expected to see in schemes providing money purchase benefits. Since the code was introduced, there have been significant changes to the legislation governing schemes providing DC benefits including the introduction in April 2015 of the DC flexibilities, the charge cap, statutory governance standards and the requirement for the chair's annual statement.

The Regulator states that the activities, behaviours and processes supported by the DC quality features are now well established and should be business as usual for trustees. The introduction of new legal duties has therefore given the Regulator the opportunity to strengthen its approach to scheme governance and administration through the development of standards set out in the new code. The Regulator states that the quality features formed the basis for these standards, and in its self-assessment template (reported further in the action points section below) a table is provided which demonstrates how the features relate to the standards in the new code.

The Regulator also reports that industry feedback suggested that the original version of the code was too long and complex. One of the design principles governing its approach to the new code was therefore that it should be "short and simple". Two ways in which the code has been shortened are that: (i) it is now assumed that trustees have a good level of knowledge of the legislation and therefore it does not set out in detail all the requirements of the law; and (ii) as the Regulator thinks that the standards set in the

original version are now well established this has reduced the need to include the same level of guidance in the new code. However, the accompanying guidance is now longer.

The new code is not expected to increase costs significantly for those running schemes relative to compliance with the 2013 code, and excluding costs that might be incurred as a result of complying with the underlying legislation.

As with all the Regulator's codes, it is not necessary to follow all the provisions of the new code in every circumstance as long as the underlying legal requirements are met. The Regulator notes that in many instances the code is not prescriptive about the particular methods that trustee boards should use to meet the standards and that they will need to make judgement calls about what is reasonable and proportionate for their scheme. The guidance is also not intended to be prescriptive, although in some places it does set out the Regulator's view of what is best practice.

The code is divided into six sections - the trustee board, scheme management skills, administration, investment governance, value for members, and communicating and reporting - with an accompanying guidance document for each section. The Regulator intends that the code and guidance will be accessed primarily online - users will be able to link directly from the code to the related guidance and to the relevant legislation.

## THE TRUSTEE BOARD

Standards in the code relate to the fitness and propriety of new trustees, appointing a chair of trustees, having an MNT process in place, and the new requirements for master trusts.

This section of the code looks at the need to consider fitness and propriety of candidates when appointing new trustees. This issue was covered in the 2013 version of the code but the accompanying guidance now also looks at gathering information which may be needed to help with this assessment, notes that trustees may find it useful to put in place a fitness and propriety policy to ensure a consistent approach, and contains additional information about succession planning.

The new code provides information about the statutory requirement introduced in April 2015 for schemes providing DC benefits to appoint a chair of trustees. It states that the Regulator expects trustee boards to have a robust and documented process in place for appointing a chair which considers the leadership qualities of candidates and their ability to drive good practice within the scheme. The guidance also addresses the role of the

chair including setting out a list of useful skills for the chair.

The new guidance also has a detailed section about board composition which includes that trustees should give serious consideration to appointing a scheme secretary. The guidance notes the areas in relation to which it is best practice for the scheme secretary to assist the trustee board which include: developing and operating a strategy to achieve the objectives set out in the scheme's business plan; documenting and reviewing scheme policies and processes; helping to manage day-to-day relations with advisers; planning and facilitating meetings; and carrying out board effectiveness reviews.

The new version of the guidance also contains more detail about sub-committees than the 2013 version of the code. This section includes that trustees should ensure that sub-committees have terms of reference agreed, documented and regularly reviewed.

The new guidance provides information about board meetings and provides a list of topics that should be covered at most meetings such as investment performance and strategy, risks to the scheme, administration, communications, any relevant updates in the law, and trustee training plans. Key issues for trustee meetings was also considered in the 2013 code although there have been some additions to the list including sub-committee decisions. The new guidance also provides information about frequency of meetings noting that what is appropriate will vary according to the circumstances of the scheme but in most cases this will be at least quarterly.

The new statutory requirement for relevant multi-employer schemes (that is, master trusts) to have at least three trustees, the majority of whom are non-affiliated, is also covered in the code and the guidance.

## SCHEME MANAGEMENT SKILLS

Standards in the code relate to trustee knowledge and understanding (TKU), appointing and managing relationships with advisers and service providers, working effectively with the employer, conflicts of interest, and risk management.

Some areas of particular note where additional information is provided include the following.

- The new guidance has some additional detail about appointing advisers and service providers and about reviewing contracts for services including a checklist of example questions for trustees to ask themselves when reviewing a new or existing contract (although it is noted that these will vary depending on the

scheme, the type of service required and the criteria used to select the adviser or service provider).

- There are some differences in the risk management process in the new guidance compared to the 2013 version of the code including the following: (i) in relation to stage 1 on identifying risks it states that in particular trustees should be vigilant to key risks such as pension scams and risks relating to cyber security threats; (ii) the guidance includes an example risk register; and (iii) previously stage three considered managing risk and stage four looked at effective monitoring of risk management controls, but there is now a single stage of "treating risks".

## ADMINISTRATION

Standards in the code relate to understanding administration (for example, considering administration at trustee meetings, understanding the scope of the administrator's responsibilities, and receiving reports), and prompt and accurate processing of core financial transactions such as investing contributions and paying benefits. The standards in relation to accurate processing address key issues concerning record-keeping such as common data, conditional data, and data review exercises.

The code opens this section by stating that "*Good administration is the bedrock of a well run DC scheme*". It notes the Regulator's expectations in this area including that: (i) the trustee board will consider administration as a substantive item at every regular meeting; (ii) administration will feature on the scheme's risk register; (iii) trustees will regularly receive appropriate information or stewardship reports from their administrators; and (iv) trustees will adopt procedures to check that whoever carries out their scheme administration has the appropriate training and expertise. The new guidance generally has more detail on administration matters, with sections covering issues such as: working with the administrator; administration reporting; administrator training and experience; quality assurance and continuity; and disaster recovery and business continuity planning. The new guidance also states that the Regulator encourages trustees to establish whether their administrator has obtained independent voluntary accreditation such as the standard offered by the Pension Administration Standards Association.

### Core financial transactions

One of the new statutory governance standards introduced in April 2015 for schemes providing DC benefits is that the trustees must secure that "core financial transactions" are processed promptly and accurately. Examples of "core financial transactions" include investment of contributions to the scheme,

transfers of assets into and out of the scheme, transfers of assets between different investments within the scheme, and payments from the scheme to members. The 2013 version of the code also included a section about prompt and accurate processing of core scheme financial transactions but this pre-dated the specific statutory requirement and therefore was included as part of the requirements for adequate internal controls.

In light of the new statutory requirement, the code now contains more information about this area including that the Regulator expects trustee boards to: (i) use electronic means to process financial transactions wherever possible; (ii) have service level agreements in place with their administrator and to keep these under review and aligned with the requirement to promptly process core financial transactions; and (iii) treat legislative timescales as absolute maximums and not to consider them equivalent to 'prompt'. In terms of timescales for investing contributions (including sums transferred into the scheme), the Regulator expects that:

- where a scheme operates a daily dealing cycle, they are invested within a maximum of three working days following receipt, and after completion of a reconciliation exercise; and
- where the dealing cycle is less frequent, they are invested at the next available dealing date, and within a maximum of five working days, after completion of the reconciliation exercise.

The new guidance provides more detail supplementing this area of the code including three examples highlighting what the Regulator will and will not consider to be a delay. These examples cover issues such as completing certain checks before making a transfer, annual leave of the administrator, and waiting for a trustee to authorise a BACS payment.

In relation to transfers, the Regulator's new guidance includes that in order to minimise the time spent gathering and exchanging information with the receiving or transferring scheme, the use of a platform that facilitates standardised information and the electronic processing of transfers should be explored. It is also worth noting that the consultation on the draft guidance included questions about whether a recommended timescale should be set for transfers to be completed. A timescale has not been included in the final form of the guidance with the Regulator acknowledging concerns that doing so could create pressure to reduce due diligence. However, the Regulator thinks that there is further benefit in increasing transparency on performance and will use information already reported to it through the scheme return to produce further best practice in the

new year to highlight industry standards and help trustee boards scrutinise their own processes.

### Record keeping

The new code and guidance also cover the issue of record-keeping and, like the 2013 version of the code, cover the key areas of common data, conditional data, data review exercise, and data protection. New points of note include that: (i) the guidance now has a specific section about the importance of taking steps to ensure member addresses are up to date; and (ii) the code states that the Regulator expects trustee boards to make arrangements to ensure that contributions and investments, and the records relating to them including member records are reconciled at least monthly.

## INVESTMENT GOVERNANCE

Standards in the code cover the areas of understanding and documenting investment matters, setting investment objectives and investment strategies, monitoring and reviewing investment strategies and fund performance, and security and liquidity of assets.

The key areas covered in the code in relation to investment governance are broadly similar to those covered in the 2013 version. The new code looks at: understanding and documenting investment matters; setting investment objectives and investment strategies; monitoring and reviewing investment strategies and fund performance; and security and liquidity of assets. Notable changes made since the 2013 version of the code include the following.

- Information is included about the new statutory requirements in relation to "default arrangements" for certain schemes providing DC benefits. For these purposes, there is a statutory definition of "default arrangement" which covers not only an arrangement into which contributions are placed without the member having expressed a choice but also arrangements in which 80% or more of members have actively chosen to invest at any relevant time. The requirements relate to having a statement of investment principles in relation to the default arrangement and reviewing the performance of the default arrangement.
- The guidance has some new sections including on fiduciary management, the Law Commission's 2014 guidance on how trustees should consider financial and non-financial factors, and providing some additional information about assessing the security of assets.

- The new guidance states that it may be helpful to prepare a matrix, or table of accountabilities, showing the delegation and control structure within the scheme and provides an example table of accountabilities in an appendix.
- There is more detail about the process of designing investment arrangements in a more general section about designing these (including default arrangements) which covers: understanding the membership; interpreting the data; implementing the objective; available market options; bespoke arrangements; additional fund options; fund selection; and documentation.
- In relation to the DC flexibilities, it is worth noting that:
  - the section of the code on setting investment objectives and strategies states that the Regulator expects trustee boards to regularly take steps to engage with members about the date they may wish to take their benefits and any preferences they have about how to take their DC benefits, and to consider any information provided when determining investment options to offer and strategies for the scheme; and
  - the section of the guidance on designing investment arrangements notes that there is currently not a great deal of widely available data to help trustees predict the retirement choices members might tend towards in light of the DC flexibilities. It also states that: members' views may be sought but they may not have a firm view; as more members use the flexibilities, the structure of the benefits they take may change; trustees may choose to take the trends in members' choices into account by analysing the behaviour of members through the scheme data and the ways in which they choose to access their benefits; and trustees may wish to supplement their views with those of their administrators and by observing wider market trends for similar organisations.

## VALUE FOR MEMBERS

Standards in the code look at the Regulator's expectations in relation to the new statutory governance standard requiring an assessment of value for members, and at the new statutory charge controls including the charge cap.

The new statutory governance standards introduced in April 2015 include that the trustees of schemes providing DC benefits must at least annually calculate the charges and, in so far as they are able, transaction costs borne by members of the scheme and assess the extent to which they represent good value for members.

There is a new section in the code, supported by accompanying guidance, relating to this requirement. Whilst the Regulator's previous guidance had a section on value for money the Regulator subsequently added a note to the guidance flagging that this was written before the new requirements were introduced and was not therefore directed at assessing value for members.

The code states that, in the Regulator's view, charges and transaction costs are likely to represent good value for members where the combination of costs and what is provided for the costs is appropriate for the scheme membership as a whole, and when compared to other options available in the market. The Regulator expects trustee boards to consider the following four areas as a minimum when they assess value for members - scheme management and governance, administration, investment governance, and communications.

The new guidance includes an illustrative approach to assessing value for members which covers the following.

- Step 1 - gather information on what the scheme provides for members and at what cost.
- Step 2 - assess the scope and quality of scheme services to members. This includes the key questions (i) are the benefits provided by the scheme's services suitable for, relevant to and valued by members? (ii) 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.

This part of the code and guidance also looks at the legislation introduced in April 2015 and April 2016 in relation to charging structures, the charge cap, the ban on active member discounts, and the ban on member-borne

commission. It is worth noting that the code states that a scheme which fully complies with the charge controls will not necessarily provide good value for members.

## COMMUNICATING AND REPORTING

In relation to communications, the standards in the code look at general principles such as the need for communications to be accurate and clear, the statutory requirements to signpost Pension Wise and to provide generic retirement risk warnings, and providing information about spotting pension scams. In relation to reporting, the standards look at the chair's annual statement and reporting information to the Regulator.

The 2013 version of the code did not contain a section about communicating and reporting, but there was some general information about communications in the Regulator's guidance.

### Communicating

Like the previous guidance, the new code notes the need to ensure that all communications sent to members are accurate and clear. The new guidance looks at general principles concerning communications such as knowing your members and seeking their views; ensuring communications are accurate, clear, relevant and in plain English; and reviewing communications. The new documents also provide information about statutory requirements introduced in April 2015 to signpost Pension Wise to members and introduced in April 2016 to provide retirement risk warnings.

You can read more about the statutory requirement to provide retirement risk warnings in our [Pensions Alert dated 24 March 2016](#). However, it is worth noting that the Regulator's example best practice process for providing information at retirement covers both the minimum legal requirements and additional actions that it considers best practice. Examples of the additional points in the best practice process include the following.

- The process states that the trustees should **not** send an application form for any options at the same stage as providing the information required by the disclosure regulations but the statutory requirements acknowledge that these, and therefore also the risk warnings, might be sent at the same time.
- The process envisages the application form incorporating a request for the member to sign a declaration confirming whether they have received Pension Wise guidance or regulated advice and that they have read the risk warnings, but this does not form part of the statutory requirements.

The appendix to the new guidance also sets out some example text for generic risk warnings. It should be noted that there are some differences between this example wording and that previously provided in the Regulator's April 2015 guidance on communicating with members about the DC flexibilities. These include the addition of introductory wording and information about the ability to choose more than one option or to keep retirement savings where they are.

It is also worth noting the following points in relation to communications:

- the code states that the Regulator expects trustee boards to include clear information on how to spot a scam in all relevant communications to members, including within standard communication materials such as the retirement wake-up pack; and
- whilst not part of the code or guidance on communications, the Regulator's website also contains information on communications to members about tax relief which notes that there are two tax relief arrangements that may apply to member contributions - net pay arrangements and relief at source - and that these arrangements may affect higher and lower paid scheme members in different ways. The Regulator expects members to be provided with clear and accurate information about whether they qualify for tax relief on their contributions and if they have to do anything to claim it. The Regulator also provides some example wording that can be used.

## Reporting

Reporting is another new area addressed by the code and guidance which cover issues including the annual chair's statement. In relation to the chair's statement, the code states that the Regulator expects it to be written in such a way as to provide a meaningful narrative of how, and the extent to which, the governance standards have been complied with. The guidance includes a section about what should be in the chair's statements although it states that there is no set format or standard template that has to be used. The Regulator notes that various advisory firms and organisations have produced templates which trustees may wish to use as a starting point.

Responses to the consultation about the guidance included that a template to assist in producing the chair's statement would be useful. In its response, the Regulator states that it remains of the view that it is not appropriate for it to provide a template. However, the Regulator also states that: where it sees good examples during the course of its regulatory activity, it will consider including

them in guidance material as appropriate; and it encourages schemes to publish their statements (for example, on their website where applicable) as a matter of course to enable ease of member access to it. The Regulator also notes that publishing more widely will assist in sharing practices across the industry.

## COMPLIANCE AND ENFORCEMENT

At the same time as publishing the final versions of the new code and accompanying guidance, the Regulator published an updated version of its compliance and enforcement policy in relation to schemes providing money purchase benefits. Overall, the Regulator's approach remains to educate and enable but where there is a failure to comply with the law it will consider taking enforcement action. Where trustees fail to comply with the requirement to produce the annual chair's statement, the Regulator **must** issue a financial penalty of between £500 and £2,000. The policy sets out how the Regulator will generally calculate the level of this penalty which involves taking into account the number of members, previous breaches and whether there is a professional trustee in place.

## ACTION POINTS FOR TRUSTEES

Trustees of schemes which provide DC benefits should consider assessing their schemes against the relevant standards in the code (noting that in particular not all of the legal requirements apply to schemes where the only DC benefits are AVCs). The Regulator has produced a self-assessment template to help trustees assess their scheme. This is similar to the tool which the Regulator previously provided for trustees to assess their scheme against the DC quality features and, as noted in the overview above, it includes a table showing how the standards relate to the quality features.

The new template is divided into sections corresponding to the sections of the new code and lists questions which enable trustees to consider whether they comply with the standards in the code. The template has space for the trustees to record their answers and mark the particular standards as either:

- green - standards met or an equivalent approach taken;
- amber - some standards not met and an action plan should be put in place; or
- red - none of the standards are met and an action plan should be put in place.

As trustees make their assessment, they may also want to consider consulting the accompanying guidance for practical examples, although noting that the guidance is not prescriptive and they need to consider what is appropriate for their scheme.

In addition, as trustees encounter particular issues for their scheme (such as the appointment of a trustee or an adviser, reviewing their investment funds or issuing a particular communication), they may find it useful to refer to the relevant sections of the code and the guidance.

## **FURTHER INFORMATION**

If you would like further information or advice about the code and the guidance and the implications for your scheme, please get in touch with your usual DLA Piper pensions contact.

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