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Draft code of practice no. 13

Governance and administration of occupational defined contribution trust-based pension schemes

July 2013

The Pensions
Regulator

Draft code of practice no. 13

**Governance and administration
of occupational defined
contribution trust-based
pension schemes**

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not made.**

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**Governance and administration of occupational
defined contribution trust-based pension schemes**

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Introduction

1. This draft code of practice (the DC code) is issued by The Pensions Regulator (the 'regulator'), the body that regulates occupational and personal pension schemes provided through employers.
2. The regulator's statutory objectives¹ are to:
 - protect the benefits of pension scheme members
 - reduce the risks of calls on the Pension Protection Fund
 - promote, and improve understanding of, the good administration of work-based pension schemes
 - maximise compliance with the duties and safeguards of the Pensions Act 2008.
3. The regulator has a number of regulatory tools, including issuing codes of practice, to enable it to meet its statutory objectives.
4. Codes of practice provide practical guidelines on the requirements of pensions legislation. They set out standards of conduct and practice expected of those who must meet these requirements².

Status of codes of practice

5. Codes of practice are not statements of the law and there is no penalty for failing to comply with them. It is not necessary for all the provisions of a code of practice to be followed in every circumstance. Any alternative approach to that appearing in the code of practice will nevertheless need to meet the underlying legal requirements and a penalty may be imposed if these requirements are not met. When determining whether the legal requirements have been met, a court or tribunal must take any relevant provisions of a code of practice into account³.
6. If there are grounds to issue an improvement notice, the regulator may issue a notice directing a person to take, or refrain from taking, such steps as are specified in the notice. These directions may be worded by reference to a code of practice issued by the regulator⁴.

¹ Section 5(1) of the Pensions Act 2004 (c.35).

² Section 90(1) of the Pensions Act 2004.

³ Section 90(5) of the Pensions Act 2004.

⁴ Section 13(3) of the Pensions Act 2004.

This code of practice

7. This DC code is underpinned by a number of defined contribution (DC) quality features that describe those activities, behaviours and control processes that are more likely to deliver good member outcomes. The DC quality features are set in the context of their legal requirements and represent the standards we expect trustees to attain. They will help trustees to demonstrate they are complying with legal requirements.

8. The practical guidance sections in this DC code are not intended to prescribe the process for every scenario. They do, however, provide principles, examples and benchmarks against which trustees can consider whether or not they are reasonably complying with and have understood their duties and obligations.
9. If trustees are, for any reason, unable to act in accordance with the procedures set out in this DC code, or an alternative approach that meets the underlying requirements, they should consider their statutory duty under section 70 of the Pensions Act 2004 to assess and if necessary report breaches of the law.

To whom is this code directed?

10. This DC code applies to trustees of all occupational DC trust-based pension schemes with two or more members (whether active, deferred or pensioner) which offer the following types of benefit:
 - money purchase benefits, including additional voluntary contributions (AVCs) under occupational defined benefit (DB) trust-based pension schemes or sections and the DC element of hybrid schemes
 - money purchase benefits with a DB underpin: we would normally expect these benefits to be treated as money purchase benefits throughout their lifetime but with the relevant DB legislation and supporting codes of practice and guidance also applied to the underpin (as trustees must ensure that appropriate funding is in place for the underpin).
11. This DC code also applies where governance and administration functions described in the DC code applicable to trustees have been delegated to a sub-committee or outsourced.
12. This DC code does not apply to:
 - schemes providing DB benefits only or DB benefits in hybrid schemes
 - work-based personal pensions, stakeholder schemes or other contract-based schemes.
13. For the avoidance of doubt, nothing in this DC code impacts on these two types of arrangements. These continue as described in existing codes and guidance issued by the regulator.

Terms used in this code

14. For the purpose of this DC code, reference to 'trustees' includes trustee directors of a corporate trustee.

How to use this code

15. The DC code is structured as a reference document to be used by trustees to inform their actions in five core areas of scheme governance.
16. While trustees need to be familiar with the DC code as a whole, we suggest they work through each section systematically. For example, trustees could prioritise sections of the DC code and work through the detail on a modular basis.
17. In certain areas, the practical guidance sections have been drafted to address issues which may be more relevant to particular types of schemes, for example master trusts.
18. We define a master trust as an occupational trust-based pension scheme established by declaration of trust which is or has been promoted to provide benefits to employers which are not connected and where each employer group is not included in a separate section with its own trustees. For this purpose, employers are connected if they are part of the same group of companies (including partially owned subsidiaries and joint ventures).

Other relevant codes of practice

19. The DC code provides trustees with a central point of reference for areas of governance addressed by the DC quality features. The DC code draws on information already contained in two other codes of practice – **Code of practice no. 7: Trustee knowledge and understanding** and **Code of practice no. 9: Internal controls** and builds on the requirements from a DC perspective.
20. Trustees should also read the following codes of practice in conjunction with this DC code:
 - Reporting breaches of the law
 - Trustee knowledge and understanding (TKU)
 - Internal controls
 - Reporting late payment of contributions to occupational pension schemes
 - Member-nominated trustees/member-nominated directors – putting arrangements in place
 - Early leavers – reasonable periods
 - Dispute resolution – reasonable periods.
21. Trustees of schemes which offer hybrid benefits should read this DC code alongside all our codes.

Relationship with the DC regulatory guidance

22. The DC code and **DC regulatory guidance: Governance and administration of occupational defined contribution trust-based pension schemes** address the DC quality features that we expect to be present in all occupational DC trust-based schemes that provide money purchase benefits.
23. The DC code focuses on quality features that are related to the requirements of pensions legislation and the DC regulatory guidance covers those quality features that reflect our view of good practice.
24. Trustees should read the DC code and DC regulatory guidance in conjunction with each other.

Northern Ireland

25. In this DC code, references to the law that applies in Great Britain should be taken to include corresponding legislation in Northern Ireland. The appendix to this DC code lists the corresponding references.

Know your scheme

26. This section covers:

- understanding trustee duties
- reviewing and updating skills and knowledge.

Understanding trustees' duties

DC quality features

In a quality scheme, trustees will:

- understand their duties and be fit and proper to carry them out
- ensure that sufficient time and resources are identified and made available for maintaining the ongoing governance of the scheme.

Legal requirements

27. Trustees of occupational DC trust-based pension schemes must have knowledge and understanding of:

- law relating to pensions and trusts
- principles relating to investment matters⁵.

28. In relation to a trustee's knowledge of pensions and trusts law, trustees must have an appropriate degree of knowledge and understanding to enable them to properly exercise their functions as a trustee⁶.

29. Trustees must be conversant with (ie have a working knowledge of) relevant scheme documents to be able to use them effectively when carrying out their duties. Relevant documents include the scheme rules, the scheme's statement of investment principles and any other documents which relate to administration of the scheme.

⁵
Section 247–249 of the Pensions Act 2004.

⁶
Section 247(5) of the Pensions Act 2004.

30. Trustees with any special knowledge or experience, or who act as a trustee in the course of a business or profession, must meet a higher standard of care as set out in the Trustee Act 2000⁷. In relation to investment, all trustees must take advice from professional advisers regulated by the Financial Services and Markets Act 2000⁸. They must use special knowledge or experience in a manner that would reasonably be expected of a person acting in the course of that kind of business or profession. When considering the internal controls provisions⁹ in the Pensions Act 2004, trustees will have to manage these obligations.

10

Practical guidance to help trustees

Deciding what level of knowledge is required

31. Trustees should read their scheme's rules, deeds of amendment, statement of investment principles, payment schedule, member booklets and other key member communications. They should understand these documents in enough detail to know where to refer to a particular provision in the event an issue arises.
32. For example, to aid discussions around investment options, trustees should be familiar with the scope of their investment power. They should understand key elements of their statement of investment principles and identify any constraints to investment decision-making.
33. We expect a trustee's breadth of knowledge and understanding to be sufficient to allow the trustee to understand fully any advice they are given. We expect trustees to be able to challenge any advice they are given and understand how advice impacts on any decisions for which they are legally responsible.
34. The level of knowledge and understanding required of trustees will vary according to the role and expertise of the trustee and the type of scheme. For example, we expect a trustee of an occupational DC trust-based pension scheme who is also an investment expert (for instance as a result of their day job) to have a greater level of knowledge than what we would consider appropriate for trustees without this background. However, all trustees should attain appropriate knowledge so that they are able to understand the key areas around investment in some detail.
35. A professional trustee (ie someone who acts as a trustee in the course of their business or profession and charges for their services) is expected to have a higher level of knowledge than a lay trustee.

7
Section 1 of the Trustee Act 2000.

8
Section 36(3) of the Pensions Act 1995.

9
Section 249A of the Pensions Act 2004.

10
Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

What trustees need to know

The benefits that the scheme offers

36. Trustees of occupational DC trust-based pension schemes should be familiar with the benefits offered under their scheme. In particular, they should understand what constitutes a money purchase benefit as described in the Pensions Act 2011 and be familiar with exactly where their scheme fits within this. In the case of hybrid schemes, trustees should ensure they understand the differences between the treatment of money purchase benefits and DB benefits, and how money purchase assets are held compared with the DB assets.
37. Details of the types of benefits offered are usually described in the scheme rules so it is important that trustees understand these. They are also described sometimes in members' terms of employment. While trustees are not expected to review members' terms and conditions of employment, they may want the employer(s) to confirm that scheme benefits are consistent with terms of employment.
38. Trustees should also establish whether the employer(s) intends their scheme to be used as an automatic enrolment scheme.

The scope of trustees' powers under the rules

39. Trustees of occupational DC trust-based pension schemes must understand the extent of key DC powers in their scheme rules¹¹, which includes the following.
 - **The scope of the trustees' investment power.** Trustees should review this power to understand the extent (if any) to which their power of investment under the rules is limited.
 - **The scope of the trustees' power to amend their scheme.** Trustees should establish who has the ability to amend the scheme rules – is it the trustees, employer, provider (in the case of master trusts) or a joint power? This rule is key as it determines who has the power to change future service benefits, for example where contribution structures are written into the rules.
 - **Who has the power to appoint and remove trustees**
 - **On what basis the trustees can act.** For example, whether decisions are made by majority vote or must be unanimous. Specific arrangements for the numbers and identities of trustees signing documents are often made outside the scheme rules, but trustees should establish what these arrangements are and ensure they are clearly documented.

11
Sections 247-249 of the
Pensions Act 2004.

- **Whether trustee powers to appoint or remove advisers are limited**
- **Who has the power to authorise bulk transfers in and out of the scheme**
- **The scope of the power to terminate and wind up the scheme.** In particular, trustees should ensure they understand the process involved to ensure the security of members' benefits on winding up.

Key issues for trustee meetings

40. Trustees need to make sufficient time to discuss key issues affecting their scheme. The issues that are likely to appear as regular agenda items include the following.
- **Investment monitoring** to address the appropriateness of investment strategies (particularly the default strategy) and fund choices. Trustees should periodically invite managers to attend meetings to discuss reports, evaluate market conditions and consider reasons for short-term fluctuations in performance
 - **Scheme risks** to determine whether the profile of key risks has changed
 - **Scheme costs and charges** to assess costs and charges incurred by the scheme and all scheme members
 - **Administration** to ensure the administration services provided to the scheme are of a good standard. In-house and third-party administrators should be asked to attend trustee meetings and to provide regular (for example quarterly) updates
 - **Communications** to ensure that information sent to members (both active and deferred) is accurate, clear, understandable and engaging
 - **Legal update** to raise awareness of and understand any changes in the law (including legislation, case law and ombudsman determinations) which affect DC provision
 - **Trustee training** to ensure that trustees understand relevant issues where a gap in their knowledge has been identified or as new issues emerge.
41. Where schemes offer DB and DC benefits, it is important that trustees devote sufficient time to DC matters. It is not appropriate to tag on an important DC-related discussion at the end of a trustee meeting. Trustees should set aside enough time at meetings to address DC issues in detail. However, it may not be appropriate to have regular meetings devoted simply to AVCs where a scheme offers DB or hybrid benefits.

42. Trustees must keep written records of meetings¹² which show the:
- date, time and place of the meeting
 - names of trustees invited
 - names of trustees (and others such as scheme advisers) who were at the meeting
 - names of trustees who were not at the meeting
 - decisions made
 - date, time and place of any decisions made at the last meeting, including urgent decisions and the names of trustees who took part.

Newly appointed trustees

43. Newly appointed individual trustees have a period of six months from the date they are appointed as trustee to complete the required learning¹³. This period is designed to give new trustees time to acquire necessary knowledge and understanding. Newly appointed lay trustees should start immediately to acquire the appropriate knowledge and understanding. This should include familiarising themselves with the scheme's trust deed, rules and relevant documents.
44. Even a new trustee is accountable in law and must be equipped to make the decisions with which they might be faced. Therefore, trustees should consider offering pre-appointment training and requiring candidates to attain sufficient levels of knowledge and understanding before appointment. This will give them the necessary skills to undertake their role effectively straight away. Trustees should also consider arranging for experienced trustees to mentor new trustees.
45. Newly appointed professional trustees or trustee directors have a higher duty of care¹⁴ and should bring their experience and knowledge to the scheme upon appointment. They should have a Pensions Management Institute qualification or equivalent knowledge before they are appointed.

12
Section 49 of the Pensions Act 1995 and regulation 12 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

13
Regulation 3 of the Occupational Pension Schemes (Trustees' Knowledge and Understanding) Regulations 2006. However, this excludes functions relating to investment where trustees must take advice from professional advisers regulated by the Financial Services and Markets Act 2000.

14
Section 1 of the Trustee Act 2000 (section 249A of the Pensions Act 2004 requires trustees to manage this).

Trustees with a specialist role

46. Trustees who have a specialist role are expected to acquire a detailed level of knowledge to enable them to undertake their role properly. For example, where investment decisions are delegated to an investment sub-committee, the sub-committee should include members who have detailed investment knowledge.

47. Trustees must be aware that their individual legal duties to meet the appropriate levels of knowledge and understanding are not waived when functions are delegated to a sub-committee. This remains the case even if the sub-committee has specialised expertise and has been authorised by the main board to carry out the work or make a particular decision on the board's behalf.

Reviewing and updating skills and knowledge

DC quality features

In a quality scheme, trustees will:

- regularly review their skills and competencies to demonstrate they understand their duties and are fit and proper to carry them out
- ensure that accountability and delegated responsibilities for all elements of running the scheme are identified, documented and understood by those involved.

Legal requirements

48. An individual must have an appropriate degree of knowledge and understanding to enable them properly to exercise their function as a trustee¹⁵. Trustees should keep their knowledge and understanding up to date so that it remains relevant.

Practical guidance to help trustees¹⁶

49. Trustees need to ensure that their level of knowledge and understanding remains appropriate throughout their term of office. This includes:
- ensuring that training is a regular point of discussion at trustee meetings
 - reviewing their individual levels of knowledge and understanding at least annually to help identify and address any knowledge gaps
 - ensuring they are suitably prepared before discussions on upcoming changes affecting the scheme where trustees may have limited experience, for example corporate activities.

¹⁵ Section 247(5) of the Pensions Act 2004.

¹⁶ Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

50. Trustees should ensure that, where possible, they plan ahead for training and development requirements in preparation for scheme activities that may require new skill sets.

Training programme

51. Where an assessment identifies any knowledge gaps or weaknesses which could hinder performance, these should be documented and addressed promptly in a training programme.
52. Trustees should log all training undertaken. This will help demonstrate how they have mitigated risks associated with knowledge gaps.
53. The training programme should cover key areas such as:
 - setting an investment objective and strategy for the scheme's default strategy
 - reviewing performance against the scheme's longer term investment strategy
 - how to select appropriate fund options for members to choose from
 - how to monitor adviser and service provider performance
 - how administration of the scheme is carried out and controlled
 - the balance of powers between the trustees and the sponsoring employer under the scheme rules
 - decumulation issues, for example the processes leading up to retirement, flexible retirement and annuity options, understanding issues around open market options and communicating retirement options to members
 - understanding how certain events such as a merger, closure or full or partial wind-ups will affect the scheme and what needs to be done.
54. Trustees should make time to attend training courses and undertake independent learning to address knowledge gaps.

Trustee toolkit

55. We have developed the Trustee toolkit (www.trusteetoolkit.com), a free online training course that addresses knowledge and understanding required by trustees. Successful completion of the Trustee toolkit can help trustees to evidence that they have the appropriate knowledge and understanding. The Trustee toolkit enables users to print out their general progress through the toolkit, as well as a certificate upon successful completion.

56. Trustees must complete the Trustee toolkit or demonstrate that they otherwise meet the requirement for appropriate knowledge and understanding. This might include a record of other educational qualifications or courses attended but whatever route is chosen the appropriate level of knowledge and understanding must be obtained within six months of being appointed¹⁷.

Fitness and propriety

57. Trustees need to be fit and proper to carry out their duties¹⁸. We expect trustees to act honestly and with integrity, competence and capability, and financial soundness. When looking at fitness and propriety we will take a number of issues into account, including:

- any attempt to deceive
- any misuse of trust funds
- any breaches of trust law, particularly if these are significant, persistent, deliberate or contrary to legal advice received
- if a trustee's charges were to constitute a breach of trust or demonstrate a lack of internal controls
- if trustees persistently or seriously commit breaches of law (including pensions legislation)
- criminal convictions (other than those noted under section 29 of the Pensions Act 1995) so far as these are not spent under the Rehabilitation of Offenders Act 1974. These convictions are not limited to those involving dishonesty or deception and could involve convictions for money laundering, violence or substance abuse, for example.

58. When employers and trustees consider applications for new trustee appointments they should consider, as part of the recruitment process, the fitness and propriety requirements of all candidates. They should also review the fitness and propriety of all appointed trustees on an ongoing basis.

17
Regulation 3 of
the Occupational
Pension Schemes
(Trustees' Knowledge
and Understanding)
Regulations 2006.

18
Section 3(1) of the
Pensions Act 1995.

Risk management

59. This section covers:

- adequate internal controls.

Adequate internal controls

DC quality features

In a quality scheme, trustees will:

- establish and maintain adequate internal controls which mitigate significant operational, financial, regulatory and compliance risks
- ensure that sufficient time and resources are identified and made available for maintaining the ongoing governance of the scheme.

Legal requirements

60. Trustees must establish and operate internal controls which adequately ensure that the scheme is administered and managed in accordance with the scheme rules and the requirements of the law¹⁹. 'Internal controls' are defined in the legislation as:

- arrangements and procedures to be followed in the administration and management of the scheme
- systems and arrangements for monitoring that administration and management
- arrangements and procedures to be followed for the safe custody and security of the assets of the scheme.

61. If trustees persistently fail to put in place adequate internal controls, this may cause an administrative breach, maladministration or, in more extreme cases, result in the reduction or loss of scheme assets.

62. Where the effect and wider implication of not having in place adequate internal controls are likely to be materially significant, we expect to receive a whistleblowing report that outlines information relating to the breach²⁰.

¹⁹
Section 249A of the Pensions Act 2004.

²⁰
Section 70 of the Pensions Act 2004.

Practical guidance to help trustees²¹

63. Trustees must identify, evaluate and manage the risks that relate to their scheme²².

Stage 1: Identifying risks

64. Trustees must identify the risks that are critical to the scheme and which are likely to have a material impact on the scheme's ability to provide member benefits if they are not managed effectively.

65. Trustees should consider information drawn from a number of sources to help identify risks present in their scheme. This includes internal audit reports, service contracts, complaints, administration reports and external audit reporting.

66. Areas of risk that are likely to have a significant impact on an occupational DC trust-based pension scheme include:

- fraud (including pension liberation fraud) and the importance of independent oversight
- investment
- management of costs
- administration
- regulatory requirements
- operational procedures
- communications
- corporate activity relevant to the scheme
- retirement and members' decumulation options.

67. Once trustees have identified risk areas they should record them in a risk register. Recording risks helps to formalise risk management procedures and provides trustees with a central reference point for future trustee meetings.

Stage 2: Evaluating risks

68. Not all risks will have the same potential impact or the same likelihood of materialising. Trustees need to look at both these areas and assess which risks the scheme can absorb without the need to take further action, and which risks require adequate internal controls to reduce their incidence and impact.

69. Trustees must therefore develop a process for evaluating risks and consider the impact that risks may, or will, have on scheme operations and assess the probability of a risk materialising.

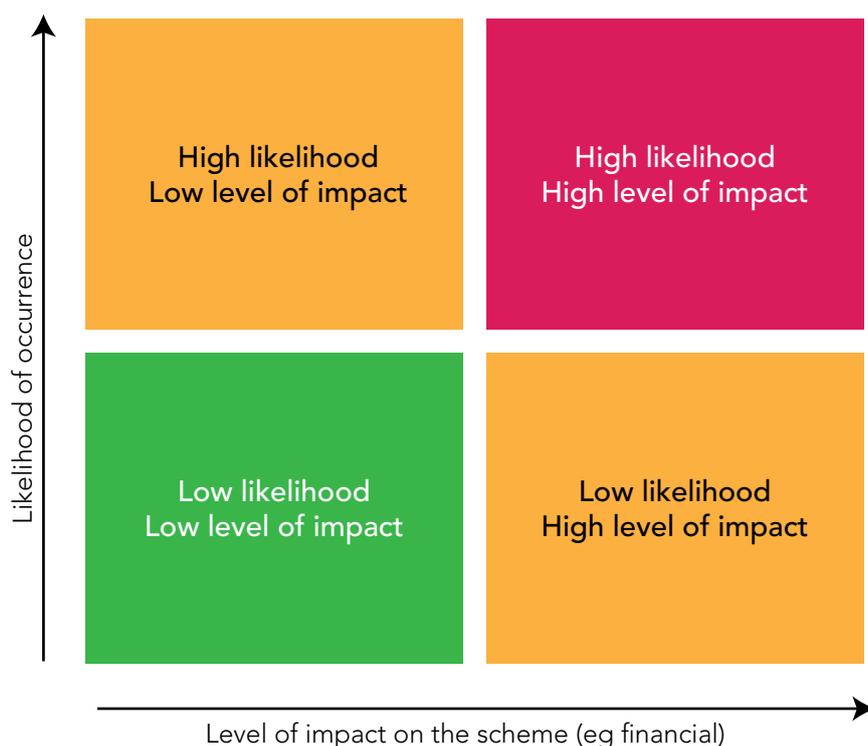
21

Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

22

Section 249A of the Pensions Act 2004.

70. The evaluation process must reflect the effectiveness of controls against suitable success criteria. It should consider the impact and likelihood of a risk occurring.
71. The basis upon which trustees measure the impact of risks may vary. However, the model below describes one simple approach trustees could use to evaluate risks. This measures the likelihood of risks occurring against the impact on the scheme.



72. In this model the classification of risk – for example red, amber or green – dictates the extent to which trustees need to take mitigating action. It is dependent upon a number of factors, including judgement. A risk categorised as red requires immediate attention as it represents a significant threat to the scheme. Where possible, these risks should be avoided altogether.
73. This is one approach trustees could use to evaluate risks. There are other risk assessment models which trustees might use that are just as effective.
74. Whichever model the trustees choose, the evaluation process should help trustees to direct resources to priority areas. It is important that trustees address all risks in a sensible order of priority, starting with those which will have the greatest impact on their scheme.

Stage 3: Managing risk

75. Simply recording and evaluating risk does not mean that risks are being managed. As part of the management and decision-making process, trustees must ensure that controls are suitably designed and implemented to enable them to take appropriate action. Trustees should consider a number of issues including those in the following table.

How the control is performed and the skills of the person performing the control.	For example, master trusts may have a large number of employers with limited experience of pension scheme administration. Trustees of master trust schemes should ensure that employers receive clear instructions addressing information requirements and support to help manage the risk of transmitting poor quality data.
The level of reliance that can be placed on information technology (IT) solutions if processes are automated.	For example, if administration services are provided using an automated system, external auditors could audit the system on an annual basis on behalf of the trustees and should audit if any issues are identified.
Whether or not a control would stop something from happening or merely detect something that has already happened.	For example, it is not possible to prevent a significant fall in global markets. However, an investment sub-committee should ensure that the main trustee board is informed enough to make a particular decision or recommendation to the main board for quick approval (subject to taking appropriate investment advice).
The frequency and timeliness of a control process.	For example, trustees who find their data is incomplete should undertake data-cleansing or member-tracing exercises and review this on a regular basis (at least annually).
The process or reporting mechanism for flagging errors or control failures.	For example, if trustees identify that member communications are poor quality, they should ensure that they are reviewed and, if necessary, redrafted.

Stage 4: Effective monitoring of risk management controls

76. Risk management is an ongoing process. Trustees must continually review exposure to new and emerging risks, including significant changes in or affecting the scheme.
77. Establishing effective internal controls relating to risk management is not a one-off exercise. Trustees should review the risk register in detail at least annually and evaluate their risk assessment arrangements, procedures and systems for material changes. They should record these changes (usually on the risk register itself) with any agreed actions to mitigate the risk.

Investment

78. This section covers:

- setting investment objectives and a default strategy
- security and liquidity of scheme assets
- monitoring and reviewing the default strategy
- reviewing investment fund performance
- investment decision-making and trustee knowledge
- acting in the best interests of members and beneficiaries.

Setting investment objectives and a default strategy

DC quality features

In a quality scheme, trustees will:

- ensure that investment objectives for each investment option are identified and documented in order for them to be regularly monitored
- ensure that the number and risk profile of investment options offered reflects the needs of the membership
- ensure that a default strategy is provided which is suitable for the needs of the membership
- act in the best interests of all beneficiaries.

Legal requirements

79. Trustees of most schemes are responsible for deciding the investment objectives and strategy adopted by the scheme. Only trustees of fully insured schemes do not need to make this decision.
80. Trustees have a very wide power to invest scheme assets. Subject to any restrictions imposed by the scheme rules, trustees have the same power to make investments of any kind as if they were absolutely entitled to the assets of the scheme²³.
81. Trustees need to consider the interests of both active and deferred members in a scheme when they make decisions relating to investment options.

23
Section 35(1) of the
Pensions Act 1995.

82. Schemes which are not fully insured must also draw up a written statement of investment principles²⁴. This statement sets out the trustees' investment objectives for their scheme and the principles governing how decisions about investments must be made. A statement of investment principles should include the trustees' policy on the following issues:

- setting the investment objective and defining, monitoring and reviewing the default strategy
- monitoring and reviewing all investments and investment funds in which the scheme assets are invested
- choosing investments and investment funds, and the balance between different kinds of investment and investment funds
- risk, including how risk is to be measured and managed, and the expected return on investments
- realising investments
- the extent to which the trustees take account of social, environmental or ethical considerations when taking investment decisions
- using the rights (including voting rights) attached to investments (if the trustees have them).

83. Trustees must review the statement of investment principles regularly – including whenever there has been a significant change in investment policy²⁵.

84. Trustees have a statutory duty to consult with the employer about the scheme's statement of investment principles²⁶.

Practical guidance to help trustees²⁷

Understanding trustees' power to invest

85. Trustees are responsible for investment governance and must be familiar with and understand the scope of the power of investment that is described in their scheme rules²⁸.

86. Trustees should use their scheme rules to identify investment powers they may delegate. They should consider whether it is sensible to establish an investment sub-committee. If they do, the trustees should document the delegation of any investment powers in an investment governance plan or as part of the statement of investment principles.

24
Section 35 of the Pensions Act 1995 and regulation 2 of the Occupational Pension Schemes (Investment) Regulations 2005.

25
Regulation 2(1) of the Occupational Pension Schemes (Investment) Regulations 2005.

26
Regulation 2(2)(b) of the Occupational Pension Schemes (Investment) Regulations 2005.

27
Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

28
Sections 247–249 of the Pensions Act 2004.

87. Trustees should be clear that they are responsible for setting and monitoring the default strategy, and for ensuring the long-term suitability of the funds underlying the default strategy. However, in relation to the range of individual funds available for members to choose to invest in, it is the members who set their strategy and the responsibility of the trustees is limited to ensuring that the funds offered perform in line with the manager's stated objectives.

Setting a default strategy

88. A default strategy (made up of one or more investment funds) will be selected automatically for a member joining the scheme, unless the member chooses to set their own strategy and chooses funds themselves from those made available by the trustees. Some schemes offer a range of pre-set, risk-rated strategies for members to choose from, although one of these will usually be set as the default strategy for members who fail to make a selection.
89. Schemes used for automatic enrolment must offer a default strategy²⁹ as new joiners must not be asked to make a choice or provide information in order to become an active member of a qualifying scheme.
90. Trustees of all occupational DC trust-based pension schemes have a duty to exercise their powers in the interests of members and beneficiaries³⁰. With the exception of AVC investments (where default strategies are rarely offered), and where they have determined this is appropriate, trustees should provide a suitable default strategy even where a scheme is not being used for automatic enrolment.
91. The Department for Work and Pensions (DWP) has issued guidance³¹ on offering a default strategy for DC automatic enrolment pension schemes. This is intended to support existing legislation. Using a high-level, principles-based approach, it covers governance, design, review, monitoring and communication of the default strategy.
92. Trustees should allow suitable time to design the default strategy and ensure that the membership data on which the default strategy is based is accurate. What is a suitable default strategy will vary from scheme to scheme depending on the needs and demographic profile of the membership.
93. Trustees should take care to understand and monitor the member-borne costs of the default strategy. For example, trustees should consider an appropriate balance between the frequency of rebalancing, which incurs trading costs, and the efficient delivery of the long-term strategy objective. They should seek to achieve equity between active and deferred member-borne costs and charges and to satisfy themselves that all costs are competitive.

²⁹
Section 17(2) of the Pensions Act 2008.

³⁰
Regulation 4(2) of the Occupational Pension Schemes (Investment) Regulations 2005.

³¹
www.gov.uk/government/publications/guidance-for-offering-a-default-option-for-defined-contribution-automatic-enrolment-pension-schemes--2.

94. Depending on the type of default strategy selected, execution of some key components may need to be delegated to a third party. For example, in a 'lifestyle' strategy, switches between the funds underlying the strategy will usually be carried out mechanically by the scheme administrator. In such circumstances, trustees should satisfy themselves that the third party has the capability and is suitably qualified to execute the trustees' requirements competently.
95. Trustees may also delegate some investment decisions in relation to the default strategy to an investment manager. For example, in a target maturity fund, a manager may be given discretion over the timing of changes in the mix of assets within the fund in order to mitigate member-borne risks in the run up to retirement. In such circumstances, trustees need to satisfy themselves that the investment manager is appropriately qualified to manage such a fund.
96. Trustees should satisfy themselves that their advisers are suitably qualified and capable of giving clear and practical advice. This will enable the trustee board to fully understand the options open to them in setting a default strategy and in delegating functions as necessary to ensure the effectiveness of their strategy. Trustees will need to be clear about what they are delegating and how they will monitor the effectiveness of delegated functions.
97. Trustees are not responsible for any act or default of any fund manager in the exercise of any relevant delegated discretion about investments as long as they have made sure that they have taken all reasonable steps to satisfy themselves that the fund managers:
 - have the appropriate knowledge and experience to manage the scheme investments
 - carry out their work competently and in line with the trustees' policy for choosing investments³².

Selecting investment funds

98. Trustees need to select investment funds for the default strategy and, if appropriate for the scheme membership, further investment fund options for members who may wish to set their own strategy.

32
Section 34(4) of the
Pensions Act 1995.

99. Trustees should devote sufficient time and resources to the following:
- Understand the objective of each investment fund. In particular trustees should understand the:
 - asset classes being invested in, for example equities and fixed interest
 - level of risk both in the strategy for each fund and in the underlying investments, for example levels of volatility for each asset class
 - objective and investment style of the investment manager, for example to replicate or outperform an index and the net of expenses target return, for example to match a cash or inflation benchmark.
 - Understand the basis upon which the total level of costs and charges is calculated and levied on the fund, for example the extent of annual management charges and other ongoing costs and charges which impact on the value of member accounts.
 - Ensure the above information is documented so that it can be used to assess the performance of the funds is in line with objectives and continues to remain suitable for members.
 - Ensure that the fund information provided to members and the employer is accurate and reflects the risk rating and investment objectives of the funds. Whilst trustees will want to ensure that members have the information that they require to make informed decisions, trustees should be careful not to give advice to members.
 - Ensure that the number and risk profile of investment funds offered as an alternative to the default strategy reflects the needs of the membership. When considering the nature of investment choices available to members, trustees should ensure that investments are suitably labelled so members understand the risk profile of investment options.
100. As with the design of the default strategy, trustees should retain appropriately qualified advisers who can provide them with professional advice and assistance. Trustees should also ensure that they, or their advisers, obtain sufficient information from their investment managers to be satisfied that they can demonstrate that they have understood all the above matters and have factored them into their solution and their range of funds.

101. Where a scheme's rules allow trustees to delegate investment decisions to an investment sub-committee, this can ensure that sufficient time and focus is given to particularly important and complex investment issues. However, all trustees (not just those on the relevant sub-committee) still remain responsible for all decisions made and actions taken by sub-committees.
102. The investment considerations of a member with a DB pension, supported by AVCs, may be different from a member who is relying solely on a DC pension. Trustees should take a pragmatic approach in these situations.

Security and liquidity of scheme assets

DC quality features

In a quality scheme, trustees will:

- predominantly invest in assets admitted to trading on regulated markets. Where unregulated investment options are offered, it must be demonstrable why it was appropriate to offer those investment options
- understand the levels of financial protection available to members and carefully consider situations where compensation is not available
- understand and put arrangements in place to mitigate the impact to members of business and/or commercial risks
- act in the best interests of all beneficiaries.

Legal requirements

103. Trustees must exercise their investment powers in a way which ensures the security, quality, liquidity and profitability of the portfolio as a whole³³. The regulations cover a range of issues together. The section below focuses on the security and liquidity of the portfolio as a whole.
104. Trustees must make sure that the scheme assets are invested predominantly in regulated markets³⁴.

33
Regulation 2(3) of the Occupational Pension Schemes (Investment) Regulations 2005.

34
Regulation 4(5) of the Occupational Pension Schemes (Investment) Regulations 2005.

Practical guidance to help trustees³⁵

105. Trustees must give due consideration to asset protection and understand what would happen in the event of a problem³⁶.
106. This is a complex area and trustees may need to seek independent advice to determine the extent to which, if at all, situations exist in which any loss caused by misfeasance in relation to the scheme's assets, or due to insolvency or default, might be covered by a compensation scheme or indemnity insurance. For example, trustees should establish whether contractual arrangements with investment platform providers include an indemnity clause in the event of default.
107. Trustees should understand the protection relating to assets held overseas either directly or through an investment fund. It may not always be possible to obtain an appropriate and enforceable financial guarantee, particularly in the context of pooled mandates. If no guarantee is available, trustees should consider the extent to which (if any) compensation arrangements and other methods of recourse are available to them if an investment provider defaults and scheme assets are lost or dissipated (other than through exposure to market risk in accordance with the set investment mandates of the fund).
108. Trustees need to understand the characteristics of complex investment instruments and investment strategies. They should put arrangements in place to ensure that members are suitably safeguarded against loss or misappropriation of assets. They should also consider such things as counterparty risk and the creditworthiness of institutions which hold the scheme's or a particular investment fund's cash positions.
109. Trustees should ensure that the levels and nature of financial protection or compensation available to members is clearly communicated to members and employers. When protection changes, this should also be communicated.
110. Trustees should establish whether:
- the investment funds and products offered to members are regulated, for example by the Financial Conduct Authority or similar regulatory authority in the case of overseas jurisdictions
 - the investment funds and products qualify for protection and compensation, for example under the Financial Services Compensation Scheme
 - members would qualify for protection and have a claim as a result of the trustee(s) being an eligible claimant.

³⁵
Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

³⁶
Regulation 4(7) of the Occupational Pension Schemes (Investment) Regulations 2005.

111. Trustees should make sure that this information is communicated to members. If trustees decide to offer investments or products which are not regulated by a relevant body they should:
- undertake additional due diligence checks on the investment to understand the regulation, compensation arrangements, governance and controls in place, and the risk factors to which members will be exposed
 - document why they have chosen these investments and why they are suitable for the membership.
112. Where the trustees consider that adequate protection does not exist they should consider how appropriate it is to hold the asset. If they decide to retain it, trustees should consider what mitigation they can put in place, for example insurance, financial guarantees or changes to contractual terms.
113. Trustees should consider the liquidity of assets held in the funds underpinning the default strategy and other funds offered to members. When a fund holds illiquid assets, it may be necessary for the fund to restrict dealing frequency. This needs to be taken into account as it may result in delays in investing contributions or rebalancing the default strategy. The out-of-market risk (ie the risk that the member faces of not having market exposure for a period of time) and the risk of being imbalanced to target as the result of such delays needs to be balanced carefully with the potential investment return premium to be gained from holding illiquid assets.

Monitoring and reviewing the default strategy

DC quality features

In a quality scheme, trustees will:

- monitor the ongoing suitability of the default strategy for the membership.

Legal requirements

114. Trustees must regularly monitor and review their scheme's investment strategy³⁷.

³⁷
Section 35(1) of the Pensions Act 1995.

Practical guidance to help trustees³⁸

115. Trustees should take time to monitor and review the appropriateness of the default strategy.
116. Certain events may trigger a review of the default strategy such as:
- a merger with another organisation which results in a change in the demographics of the scheme membership
 - a change in ownership or personnel of the investment managers
 - sustained changes in market conditions.
117. When reviewing and monitoring the default strategy, trustees should consider its suitability taking into account innovations in DC investment products, changes in regulatory requirements, the demographics of the scheme membership and innovations in the decumulation market. The review should take into account the needs of both active and deferred members. Investment and risk monitoring may help trustees to identify other potential risks. This analysis, coupled with demographic reports, helps trustees to decide whether the risk and maturity profile of the scheme membership is adequately addressed by the default strategy.

Reviewing investment fund performance

DC quality features

In a quality scheme, trustees will:

- ensure that arrangements are established to review the ongoing appropriateness of investment options
- ensure that the performance of each investment option, including the default strategy, is regularly assessed against stated investment objectives
- monitor the ongoing suitability of the default strategy for the membership.

Legal requirements

118. Trustees must regularly monitor and review the investment options that members can choose from and update their statement of investment principles accordingly³⁹.

³⁸ Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

³⁹ Section 35(1) of the Pensions Act 1995.

Practical guidance to help trustees⁴⁰

119. It is important that trustees monitor and review investment performance both for their default strategy's underlying investment funds and for other investment funds they make available for members who set their own strategy.

Fund performance review triggers

120. Trustees should build flexibility into the review and assessment arrangements. The size and value of each investment fund should be a factor in considering the nature and frequency of review. Trustees should pay particular and more frequent attention to investment funds that hold a significant proportion of scheme members' assets, for example the investment funds which underpin the default strategy.

121. The types of investment funds selected by members may also trigger a review. For example, trustees may decide to select a higher-risk investment fund to review on the basis that it is more volatile, regardless of the fact that it is likely to represent a smaller element of members' portfolios.

122. Trustees may consider setting mechanical triggers based upon the performance of investment funds against their benchmarks but these triggers need to be appropriate to the type of fund and its objective. For example, an index-tracking fund may merit triggers which are configured tightly around the index return. However, an actively managed fund holding volatile assets may merit triggers configured more loosely around its long-term performance objective.

123. In all cases, trustees should set triggers which are appropriate to the long-term nature of pension scheme investments and should not take decisions based upon short-term performance.

Form of review

124. The review may take different forms, for example based on manager or adviser reports, or involve meetings with the managers or advisers.

125. When reviewing and monitoring fund performance, trustees should:

- assess the performance of each investment fund against stated performance objectives
- compare investment returns to industry benchmarks
- consider the impact of fees on the investment return as it is the net return which members receive: the level of fees should be checked against appropriate market comparators to ensure they remain competitive

40

Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

- monitor the levels of portfolio turnover and consider whether these are justifiable in light of investment objectives and whether this results in unnecessary costs for members
- ensure that controls (including those related to the security, liquidity and safe custody of scheme assets) are in place to alert them to potential risks
- regularly assess the effectiveness of the investment decision-making and governance process, make improvements to the process as appropriate and report to interested parties (including members).

Changing investment funds

126. Where trustees decide to make a change of investment funds or investment manager, they must consider the transition options available and decide which is most suitable for the scheme⁴¹. They should ensure that there are controls around the transfer process to mitigate out-of-market risks and transition costs. Some common mitigations include:

- in specie transfers where the assets are simply reregistered rather than traded
- pre-funding which crystallises the cost of transfer and creates certainty
- undertaking phased selling to reduce volatility
- ensuring that the transfer of investments and cash between the parties is reconciled after transition.

127. Trustees should consider if any guarantees or other favourable treatment might be lost on transition and if there are any penalties which will be triggered.

128. Members should be informed in advance of the transfer so they can switch to a different fund if they do not want their investments to be automatically moved to the new fund. Most transitions will also result in a black-out period when members will be unable to view or alter their accounts and this should be communicated to members.

129. However, member communications should not delay a transfer that needs to happen urgently to protect member investments, for example due to a risk of provider insolvency. In those circumstances, communications should happen as soon as practicable after the transition.

41
Section 36(3) of the
Pensions Act 1995.

Documenting reviews of investment strategy and fund performance

130. Trustees should document the arrangements for all reviews of the default strategy and investment fund options. This should include factors considered, decisions made and actions taken. If the trustees conclude that it would be inappropriate to make any changes suggested by the review, they should fully document the reasons for not making those changes.

Investment decision-making and trustee knowledge

DC quality features

In a quality scheme, trustees will:

- understand their duties and be fit and proper to carry them out
- establish and maintain procedures and controls to ensure the effectiveness and performance of the services offered by scheme advisers and service providers.

Legal requirements

131. Investment decisions must be taken in the light of appropriate advice from professional advisers such as the scheme's investment consultants⁴².

Practical guidance to help trustees⁴³

Trustees' own knowledge

132. Trustees must have a good working knowledge of investment matters relating to their scheme⁴⁴. As a starting point, trustees should understand the characteristics of the asset classes, the key differences between those asset classes, their volatility and risks. They should also understand the nature of the investment products through which the scheme gains exposure to assets, for example whether the funds are constituted as life funds or open ended investment companies.

42
Section 36(3) of the Pensions Act 1995.

43
Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

44
Section 247-249 of the Pensions Act 2004.

Acting in the best interests of members and beneficiaries

DC quality features

In a quality scheme, trustees will:

- act in the best interests of all beneficiaries.

Legal requirements

133. Trustees must exercise their investment powers in the interests of members and beneficiaries⁴⁵. They also have a more general duty to act in the best interests of beneficiaries.
134. In acting in the best interests of members and beneficiaries, trustees should take financial interests into account. They must also set out in their statement of investment principles the extent (if at all) to which they have considered issues such as socially responsible investment (for example social, environmental and governance factors) that may affect the long-term performance of investments⁴⁶.
135. If trustees face a potential conflict of interest, they must invest the assets in the sole interests of members and beneficiaries⁴⁷.
136. Where a conflict exists, the trustees should be able to demonstrate that they effectively manage the conflict. They should take appropriate advice and make a reasonable and prudent decision based on the information available at the time.

Practical guidance to help trustees⁴⁸

137. When considering the suitability of investments, trustees should take into account environmental and social factors which may impact on longer term returns.
138. When determining whether or not the investment options are socially responsible, trustees may also want to give consideration to ethical issues which may impact on their beneficiaries.
139. Trustees need to be confident that outsourcing stewardship functions is carried out with the best interests of beneficiaries in mind. While primarily an issue for schemes investing in equity holdings (for example UK listed companies), trustees may want to determine whether a stewardship approach is appropriate for other asset classes.

45
Regulation 4(2) of the Occupational Pension Schemes (Investment) Regulations 2005.

46
Regulation 2(3) of the Occupational Pension Schemes (Investment) Regulations 2005.

47
Regulation 4(2)(b) of the Occupational Pension Schemes (Investment) Regulations 2005.

48
Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

140. For example, trustees may want to determine whether and how investment managers are exercising ownership rights. This includes monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure and corporate governance.
141. More information on quality engagement between institutional investors and investee companies is available in the UK Stewardship Code issued by the Financial Reporting Council⁴⁹.

49
www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx.

Governance of conflicts of interest and advisers/ service providers

142. This section covers:

- conflicts of interest
- appointing advisers and managing relations.

DC quality features

In a quality scheme, trustees will:

- be able to effectively demonstrate how they manage conflicts of interest
- understand and put arrangements in place to mitigate the impact to members of business and/or commercial risks.

Conflicts of interest

Legal requirements

143. A trustee decision taken from a position of conflict may be in breach of their duty to exercise their powers in the best interests of members. While it may be inevitable that conflicts of interest sometimes emerge, the important point is that they should be properly identified, monitored and managed. Trustees must ensure that they have processes in place to manage their conflicts as these will have a direct impact on members' best interests⁵⁰. Failure to do this could result in them breaching scheme rules or trust law, and their decisions and actions being revisited.

144. Trustees who are directors of either a corporate trustee or of their employer will also need to consider the requirements of section 175 of the Companies Act 2006. This requires a director of a company to avoid a situation in which they have, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company.

50
Section 249A of the
Pensions Act 2004.

145. It is beyond the scope of this DC code to consider this legislation in detail and trustees should discuss this with their legal adviser. Suffice it to say that the requirements of section 175 of the Companies Act 2006 may raise similar legal issues to those already existing under the general law on conflicts of interest affecting persons acting as fiduciaries.

Practical guidance to help trustees⁵¹

Establishing a conflicts process

146. Trustees must have a process in place to identify and manage any conflicts of those involved in running the scheme⁵². This includes trustees, service providers and advisers.

147. We expect this process to include the following key controls:

- **conflicts policy** – a document setting out the scheme’s approach to dealing with conflicts
- **register of interests** – a simple and effective tool for recording and monitoring all actual or potential conflicts (including adviser conflicts)
- **declarations on appointment** – before they are appointed all trustees, advisers and providers should declare whether there are any potential conflicts which may adversely affect their appointment and affect their decision-making
- **ongoing declarations** – trustees should ensure that terms of engagement (for example appointment letters and service contracts) include a clause requiring the adviser to operate a conflicts policy and conflicts management procedure, and to disclose all conflicts relevant to the trustees’ scheme as soon as they arise
- **declarations at start of trustee and sub-committee meetings** – trustees should include conflicts of interest as an opening agenda item and revisit it during the meeting where necessary
- **advance planning** – trustees should take time to consider what key decisions are likely to be made during the foreseeable future, and determine whether any conflicts are likely to arise.

Conflicts of interest within the trustee board

148. Generally, trustee conflicts of interest in occupational DC trust-based pension schemes are less likely to be a risk than those that may be present in DB schemes.

51
Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

52
Section 249A of the Pensions Act 2004.

149. However, this does not mean that conflicts are completely absent in DC schemes. They could, for example, arise when agreeing operational costs such as those relating to administration or communication with employers. Trustees should be alert to these types of issues and must have processes in place to manage them. These should include, where possible, seeking to ensure the trustee board has balanced representation.

Provider-appointed trustee conflicts

150. It is not uncommon for occupational DC trust-based pension schemes, particularly those set up by insurers, to appoint a trustee who is an employee of the product provider.

151. Provider representation on the trustee board can have a number of advantages, such as facilitating conversations directly with the provider. In most cases it will be possible for trustees appointed by their provider to manage potential conflicts adequately through an established conflicts process.

152. If a provider-appointed trustee of a master trust becomes aware of any business-related decisions which have a bearing on the scheme, they should consider the impact this may have on their role as trustee.

153. However, there may be situations when the provider-appointed trustee's role becomes untenable. They may face a conflict of interest which is particularly acute or pervasive, as a result of their employment with the provider. Where this is the case, the provider-appointed trustee needs to consider whether resigning is the most appropriate option.

154. One situation where this might arise could include discussions about the ability of the trustee to exercise certain powers in the scheme rules which may be coloured due to input from a trustee who holds that dual role. Other examples include strategic decisions and negotiations which could result in the termination of services offered by the provider.

155. In situations like this it may be appropriate to appoint an independent trustee to oversee decisions that may be to the detriment of scheme membership.

Managing adviser and service provider conflicts of interest

156. We expect trustees to manage their relationship professionally and independently with advisers and service providers, for example administrators, investment managers, lawyers and auditors.
157. It is not uncommon for advisers to refer the service or products offered by related parties to their clients, for which there may be some form of financial or non-financial benefit (or commercial interests).
158. For example, an adviser could be remunerated (receive commission payments) for recommending other services offered by their organisation or third party. The risk to the trustees in this situation is that the adviser does not provide, or is not seen to provide, independent advice or services.
159. While there may be benefits from these types of relationships, trustees must be fully aware of any commercial interests referred to above that may arise from these arrangements.
160. Trustees should consider what the advantages are for members in retaining a conflicted adviser/provider if they could instruct alternative advisers/providers with similar expertise who are not conflicted. Trustees should document their decisions.
161. Trustees should evaluate the nature of the adviser/provider interest. Where trustees believe that any advice or service given under these arrangements may be compromised, they should consider further measures to manage the conflict. This may include dialogue with other advisers/providers, putting the referred service out to tender, undertaking a comparison of the referred products and generally considering other alternatives before they appoint the referred party or select the product.
162. Trustees should document any action they take. They should outline general approaches to adviser conflicts in the trustees' conflicts policy, risk register or in other documented procedures. These should be subject to ongoing monitoring and review.

Disclosure of adviser and service provider conflicts

163. Trustees should ensure they are satisfied about the effectiveness of their advisers' arrangements for the management and disclosure of conflicts.

Sharing advisers with the sponsoring employer

164. Trustees should be aware of any circumstances in which their adviser or service provider provides services to the employer(s), for example benefit consultancy services. They should consider whether they are content for this situation to continue, or whether they should take steps to address potential conflicts.
165. The steps that trustees will need to take will depend on the type of adviser and advice. Trustees should ask their advisers to inform them when their advisers tender for services to an employer.

Appointing advisers and managing relations

DC quality features

In a quality scheme, trustees will:

- establish and maintain procedures and controls to ensure the effectiveness and performance of the services offered by scheme advisers and service providers
- ensure that accountability and delegated responsibilities for all elements of running the scheme are identified, documented and understood by those involved.

Legal requirements

166. Trustees have overall and ongoing legal responsibility for the administration, management and investment decisions within their scheme. Trustees must appoint auditors and fund managers⁵³ and must establish and operate adequate internal controls to ensure the scheme is administered in accordance with the law and scheme rules⁵⁴.
167. Such internal controls would need to ensure that the appointment of all professional advisers is administered and managed effectively. In addition, the professional bodies that regulate the trustees' advisers will also have their own requirements.

53
Regulation 2 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996. Exceptions to the appointment requirements are set out in the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (for example there is no requirement to appoint a fund manager where a scheme is wholly insured).

54
Section 249A of the Pensions Act 2004.

Practical guidance to help trustees⁵⁵

Appointment of advisers and service providers

168. Trustees should evaluate the suitability of all advisers and service providers prior to appointment. Trustees need to establish and document controls to manage the appointment of advisers and service providers and the delivery of information, advice and services provided by them. Trustees also need to establish and review what procedures and controls their advisers and providers have in place to ensure the quality and accuracy of the service they provide is suitable. Trustees should find out:

- what professional indemnity cover they have
- what qualifications and accreditations they have and how they keep their professional knowledge up to date
- whether they have experience of dealing with schemes of a similar size and type to their scheme.

169. Trustees should ensure that a clear and comprehensive contract is drawn up setting out the terms on which the relevant advisers or service providers are appointed. This could include (but is not limited to) matters such as:

- the scope of the work to be provided including clear service levels and escalation procedures
- the standard of care which the adviser/provider must adhere to when performing their duties
- the extent to which trustees have access to key personnel and dedicated teams and the ways in which lines of communication will operate
- data protection and data security
- agreed fees and the basis for calculating fees and additional charges
- agreements in respect of delegating functions and terminating their appointment including, for example, any termination assistance.

170. Trustees should ensure that any notice period and the basis for exit fees are reasonable. Arrangements also need to be in place for releasing information back to the trustees and any new adviser within a reasonable timescale.

171. If a service provider (such as the administrator) is not regulated, the trustees should consider what compensation arrangements (if any) are available to members if there is a significant failure by that service provider.

55

Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

172. If the trustees are not satisfied with any member financial and non-financial protections, trustees should consider whether they should be using that provider or whether they can put alternative protections in place for members, such as requiring the administrator to obtain appropriate insurance cover.

Managing ongoing adviser and service provider relations

173. Once an adviser or service provider has been chosen and appointed, there are a number of important controls that trustees should establish and operate in order to maintain a robust professional relationship. Trustees should ensure that:

- they understand information or advice provided and robustly question this advice where appropriate, for example where there is a declared conflict or the costs do not seem to offer value for money
- they understand what information the adviser needs to fulfil their role and they receive information from advisers in an understandable format
- they understand the basis for charging fees and they have documented this
- where fees are charged to members' funds they should be reasonable and fair in relation to the work carried out and represent value for money for members
- advisers are aware that they are accountable to the trustees for advice given
- they understand the procedure their adviser and service provider has in place for dealing with complaints from trustees, members or other third parties. Trustees should understand how service providers will treat any gains and losses to investments through poor administration and must ensure that they have a procedure in place to enable any person with an interest in the scheme⁵⁶ to make an application to them for a decision on a matter in dispute.

174. These issues should form the basis of a regular ongoing evaluation and assessment of all advisers' and service providers' performance and service, and trustees should have a process in place to do this regularly. Trustees should factor any risks, practical difficulties and costs to members that may be involved in changing an adviser/provider when they decide whether to change that adviser/provider.

⁵⁶
Section 50A(1) and
Section 50(1) of the
Pensions Act 1995.

Employer and member nominated trustee engagement

175. While employers participating in pension schemes do not take on an advisory role, employer engagement can be a contributory factor to a well-run scheme. Employers can provide input into important decision-making activities in which they may have a vested interest, for example the welfare of their employees.
176. Employer and member-nominated trustees can provide significant input into the running of the scheme. They can provide independence over decision-making and can challenge decisions where, in their view, the outcomes for members may not be desirable.
177. Trustees should encourage participating employers to take an active interest in the running of the scheme, not least because it may provide trustees with an additional layer of independent scrutiny.
178. Active employer engagement and employer participation on the trustee board may become a particular challenge for master trusts where, as a 'relevant centralised scheme'⁵⁷, there is no requirement to have member-nominated trustees in the same way as traditional trust-based occupational pension schemes.
179. In master trusts, member and employer representatives, and indeed employers, may have a limited opportunity to provide input or be involved in important decision-making processes. In these situations, trustees should consider particularly carefully how this may affect their understanding of the needs of members, for example different sections may have members with different risk appetites or different ages.

57
Regulation 2 of the
Occupational Pension
Schemes (Member-
nominated Trustees and
Directors) Regulations
2006.

Administration

180. This section covers:

- scheme record-keeping
- maintaining contributions and processing core scheme financial transactions.

Scheme record-keeping

DC quality features

In a quality scheme, trustees will:

- ensure that member data across all membership categories is complete and accurate and is subject to regular data evaluation
- support employers in understanding their responsibilities for providing accurate information, on a timely basis, to scheme advisers and service providers.

Legal requirements

181. Trustees must keep records of information⁵⁸ (including member data) relating to:

- the date each member joined the scheme
- details of all the contributions received
- all payments to and from the scheme
- details of transfers of members' benefits to and from the scheme.

182. Trustees must put in place adequate internal controls to manage the administration of their scheme⁵⁹. This includes maintaining accurate and up-to-date member data.

183. Trustees must provide members with an annual statutory money purchase illustration (SMPI)⁶⁰ which illustrates the likely pension at retirement based on a number of assumptions, taking into account inflation. Trustees must also provide members with details of contributions credited (before deductions) to the member in the preceding scheme year.

58
Section 49 of the Pensions Act 1995 and regulation 12 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

59
Section 249A of the Pension Act 2004.

60
Regulation 5(5) of the Occupational Pension Schemes (Disclosure of Information) Regulations 1996.

Practical guidance to help trustees⁶¹

Member data

184. Member data from employers⁶² must be accurate, comprehensive and timely. Trustees need to have processes and systems in place to support this requirement.
185. Member data which trustees hold falls into two categories. We refer to these as common data and conditional data.

Common data

186. Common data is applicable to all members of all schemes and relates to the presence and accuracy of basic information about members. All schemes should hold the common data items listed in our record-keeping guidance⁶³.

Conditional data

187. Conditional data is detailed data required for the administration of a pension scheme. The nature of this data varies from scheme to scheme and depends on many factors. In occupational DC trust-based pension schemes, the presence of these data items is conditional on:
- scheme design, for example where an occupational DC trust-based pension scheme has different contribution structures or definitions of pensionable salary used for contribution purposes
 - a member's status in the scheme, for example if lifestyling information is required or benefits are subject to a pension sharing order
 - events that have occurred during an individual's membership of the scheme, for example whether a member has transferred in benefits from another arrangement
 - system design.
188. Trustees should discuss with their administrators the exact constituents of this conditional data, based on an understanding of the requirements of their own scheme and administration system. Trustees should pay particular attention to areas such as the following.
- **Lifestyling.** Where a member is recorded as having a lifestyle investment strategy or similar phased investment pattern, trustees should check that the member's investments correctly reflect the point reached by that member within the lifestyle formula

⁶¹ Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

⁶² Section 249A of the Pensions Act 2004 and section 4 of and schedule 1 to the Data Protection Act 1998.

⁶³ www.thepensionsregulator.gov.uk/guidance/guidance-record-keeping.aspx.

- **Contributions and investments.** Trustees should ensure there are processes in place to do the following:
 - Check that there is a matching transaction for each contribution recorded and, if the investment date is held on the member record, that the contribution has been invested within five working days
 - Where a member's contributions are being invested in more than one fund, and the total amount contributed in a period is recorded explicitly, check that the sum of the individual transaction elements equals the total amount of the contribution. In addition, the allocation for investment types must equal 100%
 - Check that there is a contribution recorded for each pay period where the member is active in the scheme and that details of the investment purchased are present for each contribution received
 - Check that there is a record of each investment sold, date sold and amount realised. This should be split by investment fund, but does not have to be recorded separately for each contribution type.

Data review exercise

189. Trustees should ensure a data review exercise is conducted annually or at other intervals that they consider is appropriate for their scheme. This should include an assessment of the accuracy and completeness of common and conditional data.
190. Where the management of scheme data has been outsourced, trustees should understand what controls are operated by the administrator to ensure the integrity of member data is maintained. Trustees should ensure that the administrator has assessed the risk that poor or deficient member records have on the scheme and has taken the necessary steps to address this.
191. Trustees should ensure that data records are reviewed and cleansed, irrespective of any longer term plans, where:
- a decision has been made to wind up a scheme
 - there has been a change of administrator or the administration system/platform
 - the scheme is affected by a merger or an acquisition.
192. Where there is a change in administrator, trustees should satisfy themselves that all data is complete and accurate; they could consider using an independent party to verify this.

Data improvement plan

193. Trustees should ensure that there is a data improvement plan to address poor quality data (noting that there will be instances when trustees may have exhausted all available measures to secure accuracy).
194. The plan should have specific data improvement measures which can be monitored and tracked. The plan should have a defined end date within a reasonable timeframe with a view to having complete and accurate data.

Reconciliation of member records

195. Trustees should take reasonable steps to ensure that member records are reconciled with information held by employers, for example address changes and new starters. They should check that the number of members is as expected based on the number of leavers and joiners since the last reconciliation.
196. Trustees should ensure that they are able to determine those members who are approaching retirement, those who are active members and those who are deferred members.

Ongoing monitoring of data

197. Trustees should ensure that data is monitored on an ongoing basis to ensure its accuracy and completeness, regardless of the volume of scheme transactions. This should be in relation to all membership categories.

Retention of scheme records

198. Trustees must retain records for a minimum of six years⁶⁴. However, they need to retain some records, including both common and conditional data, for a member even after that individual has retired, ensuring that pension benefits can be settled over the benefits' lifetime.

Relations with employers

199. Trustees should be aware of the legal obligations imposed on employers to disclose information reasonably required by the trustees⁶⁵.

⁶⁴
Regulation 14 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

⁶⁵
Regulation 6 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996 sets out employers' legal obligations.

200. They should seek to ensure that employers understand the key events which require information about members to be passed from the employer (such as an HR payroll team) to the scheme administrator. These key events include when an employee:
- joins or leaves the scheme
 - changes their rate of contributions
 - changes their name, address or salary
 - retires from work or dies.
201. Trustees must ensure that there are processes with employers which enable the transmission of complete and accurate data from the outset⁶⁶. Processes will vary from scheme to scheme, depending on factors such as employee turnover, pay periods, scheme size and the timing and number of payroll processing systems.
202. Trustees should ensure that appropriate procedures and timescales are agreed for the following.
- Receiving updated information from employers when member data changes. Information should be received within timescales which enable contributions to be administered correctly. Employers could have, for example, IT systems which provide administrators with immediate updates when changes occur
 - Checking scheme data against employer data. For example, a data return could be extracted from the IT/administration systems of employers and then checked against the scheme data. This could be done at regular intervals, for example quarterly
 - Receiving information which may affect the profile of the scheme.
203. If an employer fails to act in accordance with the procedures set out above, trustees should consider their statutory duty under section 70 of the Pensions Act 2004 to report breaches of the law and assess whether there has been a relevant breach.

⁶⁶ Section 249A of the Pensions Act 2004 and principles 3 and 4 of schedule 1 to the Data Protection Act 1998.

Data protection and internal controls

204. Trustees should ensure that processes that are created in respect of member data meet the requirements of the Data Protection Act 1998 and the data protection principles⁶⁷.

205. Trustees should also understand:

- their obligations as data controllers and who the data processors are in relation to the scheme
- the difference between personal data and sensitive personal data (as defined in the Data Protection Act 1998)
- how data is held and how they should respond to data requests from different parties
- how data protection affects member communications.

Maintaining contributions and processing core scheme financial transactions

DC quality features

In a quality scheme, trustees will:

- take appropriate steps to monitor contributions and resolve contributions which have not been paid in accordance with the payment schedule in full on or before the due date
- ensure that core scheme financial transactions are processed promptly and accurately
- ensure that administration systems are able to cope with scale and are underpinned by adequate business and disaster recovery arrangements
- understand the levels of financial protection available to members and carefully consider situations where compensation is not available
- understand and put arrangements in place to mitigate the impact to members of business and/or commercial risks.

⁶⁷

For a list of the principles, see www.legislation.gov.uk/ukpga/1998/29/schedule/1

Legal requirements

206. Trustees of occupational DC trust-based pension schemes must prepare, maintain and revise from time to time if necessary a scheme payment schedule showing:
- contributions payable to the scheme by or on behalf of the employer and the members
 - other amounts payable to the scheme including, for example, expenses likely to be incurred in the coming scheme year; and
 - due date(s) on or before which payment of contributions and other amounts are to be made⁶⁸.
207. Employer contributions must be paid by the due dates set out under the payment schedule for paying them to the pension scheme. At the latest, member contributions deducted from pay must be paid to the pension scheme by the 22nd day (or the 19th day if the payment is by cheque) of the month following deduction, but these dates do not override any earlier due date set out in the payment schedule. There are special rules for the first deduction of contributions on automatic enrolment under the Pensions Act 2008⁶⁹.
208. Trustees of occupational DC trust-based pension schemes have a duty to check that contributions falling to be paid under the payment schedule are taken into the scheme in accordance with the schedule and to safeguard those contributions once they are in the scheme. They also have a duty to seek to recover any outstanding payments and debts to the scheme. Without the trustees monitoring contributions on an ongoing basis, they would not be able to carry out their duties or be able to report to the regulator where they identify that a material payment failure has arisen⁷⁰.

Practical guidance to help trustees⁷¹

Payment schedule

209. Matters relating to a scheme's payment schedule, together with guidance on steps that trustees should take to monitor contributions and resolve contributions which have not been paid in accordance with the payment schedule in full on or before the due date are addressed in the regulator's code on reporting late payment of contributions to occupational pension schemes.

68
Section 87(2) of the Pensions Act 1995 and regulations 18 and 19 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

69
Section 49(8) of the Pensions Act 1995 and regulation 16 of the Occupational Pension Schemes (Scheme Administration) Regulations 1996.

70
Sections 49 and 88 of the Pensions Act 1995, as amended by section 269 of the Pensions Act 2004.

71
Each core section includes practical guidance to help trustees to discharge their legal duties. We recognise that there may be alternative and justifiable actions or approaches trustees may wish to adopt.

Processing core scheme financial transactions

210. Trustees must operate adequate internal controls to ensure that all core scheme financial transactions are processed promptly and accurately⁷².

211. Core scheme financial transactions impact on the benefits of all classes of members (for example active and deferred) and beneficiaries. They include:

- bulk transfers in and out
- member fund switches and redirections
- receipt of contributions
- member unitisations and investment of contributions
- investment and disinvestment of scheme assets
- individual transfers in and out quotes and payments
- benefits payable on death
- purchase of annuities and payments of lump sums.

212. Trustees should ensure that:

- there are accounting procedures in place that reconcile movements and investment holdings between the investment manager and administrator
- systems continue to be able to meet the needs of the scheme and transactions to be processed throughout their lifetime
- core scheme financial transactions are processed promptly and accurately for all members – this includes having controls in place to ensure that:
 - contributions are correctly allocated to the correct funds and that changes to members' choices of funds are correctly actioned
 - all transactions resulting from investment and switching activity have been actioned promptly and correctly
 - any lifestyle and phased investment options are checked to ensure that their investments correctly reflect their position within the lifestyle/phasing process
 - transfer out payments are made promptly when sufficient checks have been undertaken on the validity of the payment: checks should include ensuring that the member has confirmed that the transfer should proceed and that the transfer will be made to a legitimate pension arrangement (this is particularly important to protect against fraudulent activity, for example pension liberation fraud)

⁷² Section 249A of the Pensions Act 2004.

- where core scheme financial transactions are not processed promptly and accurately, there is an agreed and transparent process for how errors are resolved and how members' funds will be adjusted
- anyone responsible for authorising benefits does not issue the payment (to ensure a segregation of duties): transactions should be approved before payment and signed off by at least two trustees, or by people to whom trustees have delegated authority
- controls are able to mitigate risks without preventing transactions from being processed promptly: for example, where trustees have not delegated payment authorisation to the administrator, the trustee sign-off process should not delay the processing of the transaction.

Outsourcing services

213. Trustees must ensure that they have adequate internal controls to ensure that the scheme is administered in accordance with the law⁷³. This applies equally where trustees outsource services connected with the running of the scheme.
214. Where services are outsourced, trustees need to establish and operate internal controls to manage these services and the integrity of financial information. Trustees should ask their service providers to demonstrate how their arrangements ensure that the scheme meets the relevant legal requirements in relation to the services provided.
215. Trustees need to have a clear understanding of the nature of services outsourced, including agreed responsibilities of the service provider. Trustees need to ensure the following:
- Key controls operated by the service provider include a peer review of calculations and reconciliations, as well as clear mandates for banking and investment, for example authorisation procedures
 - There is a service level agreement with the administrator which sets standards for the accuracy and timeliness of processes, and escalation processes if these are not met. Trustees should ensure that the service levels remain up to date and reflect their current expectations of the administrator, changing them as required
 - They understand the likelihood of key personnel leaving and, if so, whether their functions can be performed by others with sufficient resource and expertise

73
Section 249A of the
Pensions Act 2004.

- They are confident that risks associated with a lack of segregated duties are adequately controlled in situations where the administrator offers multiple services
- They understand who at the administrator is responsible for any statutory compliance duties which the trustees delegate to the administrator. These could include, for example, certain duties to report to HM Revenue & Customs, any reporting requirements for the annual and lifetime allowance regimes (or future equivalent) or scheme reporting to the regulator. Trustees should also ensure they understand how these functions are carried out and obtain confirmation from the administrator that there have been no breaches of that duty.

Administration systems

216. Trustees should ensure that systems used to store scheme information are capable of managing the integrity and security of member data. They should assess:

- how access to systems and data is restricted
- how data integrity is maintained
- hardware and software for new/upgraded systems.

Disaster recovery and business continuity

217. Trustees should ensure that arrangements are in place to manage risks that would have a significant impact on scheme administration and member data. Trustees should make sure that:

- there is a disaster recovery plan in place to ensure that where there is physical damage to the property or premises of any service provider:
 - data will continue to be available and accurate at all times
 - core scheme financial transactions can continue to be processed accurately and promptly at all times
 - computer hardware and software will be maintained
 - data will be regularly backed up and tested.
- the disaster recovery plan is reviewed on a regular basis (no less than annually) to reflect any changes such as to staff, roles, scheme membership, service providers or systems
- scheme administrators carry out periodic testing of their disaster recovery plans to ensure they work in practice.

Addressing systems failures

218. In the absence of disaster recovery and business continuity plans, the risk of not being able to manage certain material and unforeseen events can increase significantly, as can remedial costs. Financial costs can arise as a result of inadequate internal controls, poor processes and system failures.
219. Trustees should be confident that financial resources are available to fund the costs of putting things right, and that this is not a cost incurred by members.
220. Unlike providers of financial products, occupational DC trust-based pension schemes are not required to maintain sufficient capital to cover any member losses. When outsourcing services, trustees should take into account capital adequacy arrangements of the adviser/provider concerned.
221. Trustees should be confident that the level of cover is suitable and does not expose their scheme to financial risks that could be detrimental to member benefits.

Insuring against problems

222. Trustees should consider how they would be covered against the risks of a significant problem occurring which could impact members' benefits or the scheme generally.
223. They should consider whether it is appropriate to insure against these risks, taking into consideration the availability and level of insurance desired, the coverage offered and the cost.
224. Risks in a number of areas may be covered in, for example, the protection of assets or rectification costs, and can sit alongside other protections such as compensation schemes.
225. Where an employer offers to add pension scheme risks to a corporate indemnity policy (for example a directors and officers policy), trustees should ensure that the cover is complete and adequate, especially when compared to a tailored trustee indemnity insurance policy. They should also consider what might happen to the insurance if the employer ceased trading.

Appendix: Corresponding Northern Ireland legislation

GB legislation	NI legislation
Rehabilitation of Offenders Act 1974 (c. 53)	Rehabilitation of Offenders (Northern Ireland) Order 1978 (SI 1978/1908 (NI 27))
Pensions Act 1995 (c. 26) section 3 section 29 sections 34 to 36 section 49 section 50A sections 87 and 88	Pensions (Northern Ireland) Order 1995 (SI 1995/3213 (NI 22)) article 3 article 29 articles 34 to 36 article 49 article 50A articles 85 and 86
Data Protection Act 1998 (c. 29) section 4 and schedule 1	Data Protection Act 1998 (c. 29) section 4 and schedule 1
Financial Services and Markets Act 2000 (c. 8)	Financial Services and Markets Act 2000 (c. 8)
Trustee Act 2000 (c. 29) section 1	Trustee Act (Northern Ireland) 2001 (c. 14 (NI)) section 1
Pensions Act 2004 (c. 35) section 13 section 70 section 90 sections 247 to 249 section 249A section 269	Pensions (Northern Ireland) Order 2005 (SI 2005/255 (NI 1)) article 9 article 65 article 85 articles 224 to 226 article 226A article 246
Companies Act 2006 (c. 46) section 175	Companies Act 2006 (c. 46) section 175

GB legislation	NI legislation
Pensions Act 2008 (c. 30) section 17	Pensions (No. 2) Act (Northern Ireland) 2008 (c. 13 (NI)) section 17
Pensions Act 2011 (c. 19)	Pensions Act (Northern Ireland) 2012 (c. 3 (NI))
Occupational Pension Schemes (Disclosure of Information) Regulations 1996 (SI 1996/1655) regulation 5	Occupational Pension Schemes (Disclosure of Information) Regulations (Northern Ireland) 1997 (SR 1997 No. 98) regulation 5
Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715) regulation 2 regulation 6 regulation 12 regulation 14 regulation 16 regulations 18 and 19	Occupational Pension Schemes (Scheme Administration) Regulations (Northern Ireland) 1997 (SR 1997 No. 94) regulation 2 regulation 6 regulation 12 regulation 14 regulation 16 regulations 18 and 19
Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378) regulation 2 regulation 3 regulation 4	Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005 (SR 2005 No. 569) regulation 2 regulation 3 regulation 4
Occupational Pension Schemes (Trustees' Knowledge and Understanding) Regulations 2006 (SI 2006/686) regulation 3	Occupational Pension Schemes (Trustees' Knowledge and Understanding) Regulations (Northern Ireland) 2006 (SR 2006 No. 120) regulation 3
Occupational Pension Schemes (Member-nominated Trustees and Directors) Regulations 2006 (SI 2006/714) regulation 2	Occupational Pension Schemes (Member-nominated Trustees and Directors) Regulations (Northern Ireland) 2006 (SR 2006 No. 148) regulation 2

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