

Consultation report

A response from the Pensions Regulator

A review of the Trustee Knowledge and Understanding (TKU) code of practice (code of practice no. 7) and scope guidance

May 2009

www.thepensionsregulator.gov.uk 

Contents

Executive summary	3
What the consultation paper said	4
Main points raised in responses	4
Questions on the draft revised code of practice	4
Questions on the draft revised scope guidance	6
Additional points.....	8
Application of the TKU framework – the deregulatory review.....	9
Responsible ownership of assets.....	9
Change of duties: buy-out, buy-in	9
State pension provision	10
Proposed legislative changes.....	10
The position of Chairs	10
The position of directors of corporate trustees	10
Knowledge and understanding and conversance.....	11
The way forward	12
Appendix: List of respondents	13

Executive summary

On 8 October 2008 we began a consultation on a review of the first issue of the Trustee Knowledge and Understanding (TKU) code of practice and scope guidance, issued by the Pensions Regulator ('the regulator') in accordance with the Pensions Act 2004.

The first issue of the code came into force in May 2006, with an undertaking that the code and scope (available since 2005) should be reviewed after two years.

The background against which the review took place is different from that when the first issue of the code and scope guidance was introduced, mainly due to the bedding down of the TKU regime and the launch of the *Trustee toolkit*, our e-learning programme covering the scope guidance.

The consultation period closed on 31 December 2008. We received 23 responses from a broad cross-section of stakeholders including trustee boards, lawyers, consultants, professional and trade bodies, and other interested parties. A list of the respondents is attached as an appendix. We are grateful for all the responses received, which have helped us considerably.

We were pleased to see that respondents showed an appreciation of the TKU regime and acknowledged the step change in the confidence with which trustees now approach their responsibilities. The responses demonstrated the extent to which the regime has become embedded in the normal run of trustee activities in the very short time since it was implemented in 2006.

While a number of views were expressed on different aspects of the scope and code, and many helpful suggestions made about how we might make further improvements, there was no evidence to suggest that fundamental change was needed to the text on which we consulted. The National Association of Pension Funds (NAPF) summed up the general tone:

'The feedback we have had from NAPF members on the review indicates very strongly that the pensions community regards the proposed revisions as being helpful and appropriate.'

This document briefly sets out the questions which we asked as part of the consultation, the responses received, and our views on those responses. It goes on to cover additional comments and concerns raised by respondents.

It is important to emphasise that the original scope guidance covered what it was that trustees needed to know and understand. These requirements have not changed substantially and accordingly the revised code and scope have not substantially changed either.

What the consultation paper said

The consultation paper introduced the revised draft TKU code of practice (second issue) and the revised draft scope guidance, and detailed the proposed changes.

We also noted that we had taken the opportunity to consider carefully the Department for Work and Pensions (DWP) -led deregulatory review, undertaken during 2007, which recommended that the TKU requirements ought to apply not to individual trustees but to the whole board. Neither the DWP nor the regulator was minded to seek to amend the legislation at that time and ministers rejected this notion in December 2007.

However, concern remained that there may be misconceptions about the requirements for TKU. The consultation provided an opportunity for any such misconceptions to be aired. Additionally, in conducting this review we concluded that there was a need to reconsider the scope guidance for trustees of very small schemes. While schemes with fewer than 12 members are exempt from the requirements, occupational DC schemes with 12-99 members are included. This is the group for whom we have developed much reduced scope guidance, which we consulted on as part of this consultation.

Main points raised in responses

We asked respondents specifically to respond to ten questions. The responses and our comments are listed below. Many respondents had additional concerns or comments outside the scope of the questions; these are also covered below.

Questions on the draft revised code of practice

1. *The legislation requires that knowledge, understanding and conversance should be ‘appropriate for the purposes of enabling the individual properly to exercise his functions as trustee of any relevant scheme’.¹ In response to our consultation on the first issue of the code of practice in 2005, we gave examples of what knowledge, understanding and conversance might be ‘appropriate’ in particular circumstances. Are there any other examples which have arisen in your work which would be useful for further illustration of appropriateness?*

All respondents who answered this question seemed content with the examples given in the code. One suggestion was that examples of alternative asset classes should be spelled out. However, these are included in the scope guidance and that appeared to us to be the more appropriate place for them.

2. *Since the publication of the first issue of the code of practice the delivery of learning in the industry has become generally more participative and the regulator, in particular, has published its e-learning programme (www.trusteetoolkit.com). We have amended the references to learning delivery in this draft revised code. Do you think that this matter has been adequately addressed?*

Although the respondents who commented were positive about the toolkit, this question and the prominence given to it in the code gave rise to much comment. Many were concerned about the possibility (in their view, impossibility) of trustees being able to find an ‘exact equivalent’ to the toolkit. Indeed, several expressed the view that we seemed to

¹ Pensions Act 2004 (s247(5))

be implying that completion of the toolkit was mandatory, and that therefore we were hardening our position.

Acquisition of an appropriate level of knowledge and understanding is required by legislation. However, in recognition of these concerns, we have amended those paragraphs to reflect our original intention that the toolkit is required study for new trustees, unless they can find an alternative programme which covers all the appropriate items in the scope guidance at a level relevant for them and within the timescale allowed.

One respondent suggested that the toolkit should clearly state, on the completion of a module, which elements of the TKU requirements had been covered. The same respondent also suggested that the toolkit ought to have some kind of self-assessment. The toolkit already does both of these things.

These and other suggestions, such as the provision of the toolkit as a PDF, so that it could be printed out, lead us to suspect that some respondents are not as familiar with the toolkit as they profess themselves to be. This is of particular concern where they are themselves providing learning to trustees and advising trustees on the value of using the toolkit.

We will, however, try to make this existing functionality more prominent when we come to review the toolkit in the light of the amended scope guidance.

Some respondents commented that the toolkit should be complemented by scheme specific training by an appropriate adviser or industry trainer. This is entirely consistent with our view, expressed in paragraphs 24 and 25 of the code, which make it clear that different requirements will be appropriate for trustees of different types of scheme. Further, it is our view, supported by some of the respondents, that the scheme specific learning delivered by advisers would be of greater value if it were pitched at an audience who were at a 'post scope guidance' and 'post toolkit' level.

3. *Again, on the matter of learning delivery, there are implicit demands on those who carry this out which are not new to the draft revised code. They include:*

- *the importance of finding a way to check out the level of knowledge and understanding of delegates before the session starts;*
- *the active participation of delegates;*
- *the importance of allowing delegates to demonstrate their understanding of the matters in hand (formally or informally); and*
- *the facility to offer certification to delegates regarding their attendance, their participation and their increased knowledge and understanding (whether formally or informally demonstrated).*

To what extent are these requirements being met, and is there more the regulator could do to help those who deliver learning to achieve them?

This question gave rise to much debate. Respondents who considered this point recognised the fact that training is more effective when delivered in this way and two of them had concerns about the standard of some of the training currently being delivered. Others noted the practical difficulties of ascertaining that delegates had increased their knowledge and understanding as a result of the training, and offering certification to that effect.

Several respondents requested that we supply examples in the code of the type of activity to which we were referring. Others raised an important point about the difficulties which would arise in meeting these requirements in large seminars of the type frequently offered by investment houses and others, often at no cost.

We recognise the validity of these concerns, and have reworked the relevant paragraphs in the code to give some examples of how this requirement might be met. In respect of large seminars we have made it clear that it is not obligatory to provide certification and that we think it likely that trustees would not expect it in these circumstances. We do consider however, that it is not at all unreasonable for trustees to make these demands on those delivering bespoke learning. They are not overly burdensome and would greatly enhance the value of such sessions.

In fact, many respondents noted that, from their experience, these ideas represented the way that good practice in training delivery was developing. Indeed, this was a view shared by the NAPF and the Pensions Management Institute (PMI).

Questions on the draft revised scope guidance

- 4. The draft revised scope guidance includes reference to wind-up because of the increased interest of the regulator in schemes in wind-up and because it is clear that schemes in wind-up are covered by the TKU requirements. We have, additionally, published three modules on wind-up on our toolkit site. On the other hand, most trustees do not come across wind-up and it is therefore not appropriate for most trustees to concern themselves unduly with it. Has wind-up been covered adequately?*

The overwhelming view from the respondents was that we had covered wind-up adequately. In response to one suggestion, we have added extra mention of trustee duties in the context of wind-up in Unit 1 and Unit 10b of the scope guidance. As a couple of respondents did not seem to be aware of the existence of our discrete toolkit modules on wind-up (published outside the requirements for TKU), we will be considering how to raise their profile and improve awareness of them.

5. *Similarly, we have included reference both to buy-in and buy-out in the scope guidance because of increased regulatory interest in those areas. Have we handled these topics adequately?*

The responses received suggested that there is an appetite for learning around buy-in and buy-out and that we had handled these topics adequately. Concern was expressed that, by highlighting these topics for inclusion, the regulator might be in danger of committing itself to frequent updates as concerns come and go. In this case, we take the view that buy-ins and buy-outs will be around for some time to come and that it would be helpful for trustees to know about and understand them.

Another made the point that these are, in essence, investment matters. Indeed, that is how they are treated in the scope guidance.

6. *Do you think that it will help trustees of very small schemes to have a much reduced scope and have we got the requirements for them about right?*

- *Might there be a cost benefit in producing a reduced toolkit for those trustees which will be fully aligned with the new, reduced TKU requirements?*
- *If you have experience of these very small schemes (12-99 members) could you contribute ideas about how to reach the trustees of those schemes?*

There was general support for the reduced scope, with only one respondent perceiving little value in it. A request for a better definition of this category of scheme was made, and we have amended the title of the appropriate scope guidance accordingly.

Three respondents suggested ways to contact this pool of trustees, by linking up with IFAs, and/or using scheme returns to reach out to them.

7. *While we included administration in the first issue scope guidance, we have laid increased stress on it in the draft revised scope guidance in response to requests from those in administration in the industry and to reflect the regulator's increased interest in administration. However, administration sits slightly uneasily within the regime because it is a matter of 'doing' rather than 'knowing and understanding'. Are we right to strengthen the reference to administration on the face of the scope guidance document and have we approached it correctly?*

Those who answered the question were supportive of the increased attention given to administration in the revised scope, although some noted that it could be seen as a matter that should already be covered under the heading of governance and internal controls. Some agreed that administration came under the category of 'doing' rather than 'knowing', while recognising that improvements in administration are difficult to achieve if not enough is known about it.

8. *We have lost the direct read across from the DB/DC scope to the DC only scope to make the latter more user friendly for trustees of exclusively DC schemes. Do you agree that this is more helpful for DC only trustees and is therefore worth doing?*

This question gave rise to very little comment, although the view was expressed that anything that could be done to make the documentation more user friendly would be welcome. We have tried to reflect this in the presentation of the final documents.

9. *We have given more prominence to the employer covenant in the draft revised scope guidance than was the case in the first issue. This also reflects the increasing interest of the regulator in the employer covenant for DB schemes. Is there too much on this issue, too little or about the right amount?*

Again, this question provoked very little comment, although a couple of respondents felt that there should be more emphasis on the covenant, and one respondent wasn't convinced that trustees would understand the term.

Employer covenant issues are covered at great length and in numerous places in the toolkit. Given the take-up of the toolkit among trustees, and the widespread use of the word 'covenant' in the pensions media, we consider that trustees are likely to understand the term, and that new trustees will swiftly recognise and use it. We do not therefore propose to alter the scope in this regard.

10. *At the request of the industry we have included mention of Personal Accounts and the issue of qualification for existing schemes under that regime. In current circumstances, where details remain to be settled, would you agree that we have got this about right and would you like to see amendments as matters are decided?*

Some concern was expressed that by this inclusion we might be implying that trustees should take some sort of supervisory role, checking that employers do comply with the regime. Others, however, recognised that the emphasis was on the extent to which an existing occupational scheme qualifies for exemption under the new requirements.

Additional points

Many respondents took the time to suggest drafting improvements to the code and the scope, for which we were grateful, and we have incorporated these as appropriate.

There were, however, some concerns which deserve particular mention, even if they were only raised by one or two respondents.

Application of the TKU framework – the deregulatory review

The DWP-led deregulatory review, undertaken during 2007, recommended that the TKU requirements ought to apply not to individual trustees but to the whole board. Although this notion was rejected by the DWP, the regulator and ministers, this consultation provided the opportunity to investigate whether there were other misconceptions about the application of the requirements.

We found that the requirements were clearly understood. Only one respondent took issue with the DWP decision that the TKU requirements should continue to apply to individual trustees. Contrary to this a lawyer noted that, in their experience, even when sub-committees are used, they would tend to report back to the whole board with a recommendation on which the whole board then needs to vote. They noted that ‘because the whole board is taking decisions, the individuals which make up that board are effectively exercising all of the functions and are therefore subject to the whole range of TKU requirements in any event.’

One respondent suggested that the requirements should apply to those who run personal pensions and other contract-based arrangements. However, the legislation which introduced the TKU regime is only applicable to trustees of occupational schemes who are bound by trust law.

Responsible ownership of assets

A couple of respondents were concerned that there had been a weakening of the requirements in relation to responsible ownership of assets, and the environmental, social and governance issues to be taken into account when investing in companies. It was not our intention to weaken the requirement, and it seems that some misunderstanding may have arisen as a result of moving items from one unit to another within the scope guidance.

However, recognising that there could be an impression that the matter had declined in importance to the regulator, we have also made some amendments to the scope guidance. We have not quoted the relevant regulations (although this was requested), as we do not believe that this is an appropriate document in which to do this. The original scope guidance already made reference to the regulatory requirements for the Statement of Investment Principles and the Myners principles, and we have strengthened those references in the revised scope.

It was also suggested that trustees should have a duty to report to their members on how they exercise their rights as shareholders. Such a duty would not fall under the scope of the TKU regime. Representations in this regard should be made directly to the Department for Work and Pensions.

Change of duties: buy-out, buy-in

It was noted that unit 1 of the scope guidance should cover the change in the fiduciary duties of a trustee in a situation where the scheme is in wind-up, or where there is the prospect of either buy-out or buy-in. We agree that this would be helpful to trustees, and have added it to the scope guidance.

State pension provision

One respondent expressed concern about the inclusion in the scope guidance of the interface between occupational schemes and state pension provision. They noted that neither the trustees nor the regulator have any powers in this area. However, this requirement is not new and is confined to knowing how state pension provision impinges upon the running of an occupational pension scheme (eg the provision of guaranteed minimum pensions, the state pension age, and the fact that, at lower income levels, some means tested benefits may be lost if members have private pension income are all relevant to trustees). We still consider that it is entirely appropriate for this scope item to be included at this level.

Proposed legislative changes

Our reference in the scope for trustees to be aware of proposals for major legislative change also caused concern, as it was felt that this turn of phrase would mean a huge and, where the proposals were not implemented, possibly unnecessary task for trustees. Again this requirement is not new, but we have amended the wording to restrict it to changes already made by statute but not yet implemented.

The position of Chairs

A few respondents were concerned at what they saw to be new expectations around the role of the chair, and in particular an expectation that the chair should be an experienced trustee. It was felt that this was unreasonable, particularly given that there is no legal requirement even to have a chair. However, there was nothing in respect of chairs which differed from the original code, which clearly stated that there were particular expectations of chairs, even in the early days of their appointment.

We are satisfied that, especially in the very unusual case of a newly established scheme, members of a trustee board should be able to expect the chair of a meeting to be effective and provide guidance on the matters under discussion.

Accordingly we have amended the relevant paragraph in the code to reflect the fact that there is no legal requirement to have a chair. Rather it is the regulator's view that chairs are unlikely to be effective without having met the TKU requirements, as a minimum, even if they are new to the role of trustee. The substance of the paragraph, therefore, remains unaltered.

The position of directors of corporate trustees

In response to a request for clarity of the issue set out in paragraphs 19-22 of the revised code, we recognise that the proposed wording was not as close to the wording of the legislation as was the case in the first issue of the code. We have therefore reworked it with that in mind.

Knowledge and understanding and conversance

We were also asked to consider whether or not the code made it sufficiently clear that trustees must always consider the circumstances of their own scheme when they are determining their specific TKU requirements. We have re-examined the code carefully, and note that we have dealt with this issue in several ways at several points. We make the point specifically in paragraphs 25-26 and at paragraph 68. We also give examples of how this might work in practice, in Box 1 and in paragraph 34.

Additionally, trustees will have to consider their own scheme when considering which version of the scope guidance is appropriate to their circumstances. We are, therefore, satisfied that we have addressed this point.

One respondent mentioned how a process for the electronic management of knowledge could be of great use to trustees, and suggested some particular proprietary software for this purpose. While electronic knowledge management systems can be useful for some schemes in appropriate circumstances, it is not the regulator's role to recommend any particular way of managing knowledge, or any particular proprietary software.

There was concern around the increased requirement at paragraph 69 for every trustee to read their trust documentation thoroughly. The first issue code had only stated that trustees should know the essential elements of the trust deed and rules. This is the sole example of any raising of the bar in relation to the scope requirements. It arises both from our own experience in developing the toolkit and the wind-up module for DB schemes with an insolvent employer, and from legal advice.

We were not persuaded by the argument that some documents are too difficult and cumbersome for trustees to use. If this is the case, then the matter should be remedied in whatever way is best for the trustee board in question.

One respondent suggested we should also make reference to the Memorandum and Articles of Association where appropriate, and we have made this change.

Another suggested that it would be helpful to include in the code the fact that trustees have, under section 58 of the Employment Rights Act 1996, the right to the time off for the purposes of performing their duties as trustees and for relevant training. We have accepted this suggestion and duly included it in the new code.

The way forward

The revised code of practice will be laid before Parliament and the Northern Ireland Assembly, once approved to be forwarded by the Board of the Pensions Regulator. The revised scope guidance is not a matter for Parliament, although we shall append it for the convenience of MPs.

This document, the code of practice and the scope guidance have been published on our website and on the *Trustee toolkit* website.

We are now reviewing the *Trustee toolkit* to make sure it reflects the revised scope guidance. We expect this work to be completed by autumn 2009. In response to requests, we have published a list of additions to the scope guidance and a list of movements of items within the scope guidance. We have also set out where users can find the new items in the toolkit.

However, as stated previously, the changes are minimal and users who have already completed the toolkit or some of the modules within it will not have to redo the toolkit or those modules unless they wish to.

We will also be releasing a separate, optional module on buy-out and buy-in. Like the existing suite of modules covering wind-up, this module will also be outside the scope of the core TKU requirements. We expect to launch this module in June 2009.

While we will keep the code and scope under review, we hope that the revised documents will, like their predecessors, stand the test of time and only need alteration in the event of major legislative change.

Appendix: List of respondents

The following organisations provided responses to the consultation:

Aon Consulting

The Association of Consulting Actuaries

Buck Consultants

eShare

Eversheds LLP

FairPensions

HBOS

Hewitt Associates Ltd

The Institute of Chartered Accountants

Legal and General Assurance Society Limited

Mercer

National Association of Pension Funds

Norwich Union

Occupational Pensioners' Alliance

Pensions Management Institute

Pensions Trust

Prudential Plc

Railways Pension Trustee Company Ltd

Royal Mail Pension Trustees Ltd

Sacker & Partners LLP

Society of Pension Consultants

UK Sustainable Investment and Finance (UKSIF)

Watson Wyatt