

A guide to

Investment governance

To be read alongside our DC code of practice no. 13



Also in this series:

1. The trustee board
2. Scheme management skills
3. Administration
5. Value for members
6. Communicating and reporting

About this guide

This is one of six guides to support trustee boards in meeting the standards set out in our Code of practice 13: Governance and administration of occupational trust based schemes providing money purchase benefits ('the DC code').

- ▶ The trustee board
- ▶ Scheme management skills
- ▶ Administration
- ▶ **Investment governance**
- ▶ Value for members
- ▶ Communicating and reporting

While the DC code sets out the standards we expect you to meet when complying with the law, the guides provide information on how you might meet those standards in practice. You should read the DC code before you read this guide.

The guides aim to provide you with practical information and examples of approaches you could take, and factors to consider. The guides are not intended to be prescriptive, though in some instances we state what we consider to be best practice (ie an approach that should be followed in most circumstances). Often, the methods you choose to adopt will depend on the nature of your scheme and its membership.

In the case of AVCs, where legal obligations apply you should consider the risks to members in the context of the significance of the value of AVCs relative to members' overall benefits in the scheme, and apply a proportionate approach to meeting the relevant standards in our DC code.



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The trustee board's role in investment governance

As a trustee board, you retain ultimate responsibility for a scheme's investments, but this doesn't mean that you have to (and you may not be permitted to) do everything yourself. Certain tasks and decisions can be delegated, but you need to retain effective control, give direction, and intervene when problems are identified.

Your scheme's investment governance arrangements need to be consistent with your legal powers and responsibilities regarding investment. The Law Commission has prepared an overview:

<http://bit.ly/FidDuties>

This summarises the interaction between relevant parts of the law including trust law, pensions law, financial services legislation and the scheme's trust deed and rules.

If you're unsure about these requirements generally, you should undertake relevant trustee training. If you're unsure whether your scheme's particular investment governance arrangements are consistent with the law, you should obtain appropriate legal advice.

Where you outsource or delegate any part of the investment governance structure, you will need to be confident that those functions are still carried out with the best interests of beneficiaries in mind, and by people with the right expertise.

Investment delegation structures

Your governance structure should strike an appropriate balance between speed of action, and checks and balances to ensure that actions are appropriate. A simple investment structure might involve three parties: the trustee board, the investment consultant and the investment manager.

Under this structure, the trustee board determines the overall investment objectives and makes the strategic investment decisions, eg the risk/return profile appropriate to the membership and the proportion of the investments to hold in which asset classes to achieve this. A suitable adviser, such as the investment consultant, will advise the trustee board in their decision making. The day-to-day investment decisions, eg which individual investments to hold, are delegated to investment managers.

This structure can work well provided that the trustee board is able to devote enough time and skill to the scheme investments, and is able to convene quickly to make decisions if required.

You may be able to improve the investment governance by setting up an investment sub-committee. This can take some of the investment workload from the trustee board.

Things to consider

When deciding whether you need an investment sub-committee, consider questions like:

- ▶ What is the size of your scheme membership?
- ▶ How diverse is the membership? Do you have a variety of members with different characteristics for whom investment objectives are likely to vary?
- ▶ Does your scheme have the resources to cover the cost of a sub-committee?
- ▶ Does the complexity of your scheme require you to spend more time on investment issues outside of regular trustee board meetings?

If you decide to set up an investment sub-committee, you should aim for an appropriate balance between independent, employer and member nominated trustee (and perhaps non-trustee, eg investment consultant) members of the committee.

Fiduciary management

Fiduciary management involves a large degree of delegation to the chosen fiduciary manager. If you consider this as an option for your scheme, you should carry out enough due diligence to be comfortable with the degree of delegation involved, particularly if you propose to appoint your existing investment consultant. You should note that the skills that a successful investment consultant needs are not exactly the same as those that a successful fiduciary manager needs. You should establish appropriate reporting relationships and put suitable oversight in place so you can effectively monitor the performance of the fiduciary manager and the underlying mandates.

There is the potential for conflicts of interest of the various parties involved in choosing a fiduciary manager. This includes the existing investment consultant, and third party advisers.



See the guide on '**Scheme management skills**' for more information about managing conflicts of interest.

Clear roles and responsibilities

Regardless of the investment governance structure in place, all the involved parties need to be clear on areas where they make decisions, provide oversight, or give advice. Clear terms of reference are important for any sub-committees, as are documented service level agreements with providers (see also the guide on '**Scheme management skills**').

It may be helpful to prepare a matrix, or table of accountabilities, showing the delegation and control structure within your scheme, to help provide this clarity. An example table that you can adapt for your scheme can be found in Appendix 2. You may wish to prepare a high-level summary of the governance arrangements, explaining in a few key points what they are and why they have been chosen. This could form part of the scheme's statement of investment principles (SIP), or be part of a larger, overall governance plan. You could make it available to members, eg by publishing on the scheme's website or the employer's intranet.



See the guide on '**Value for members**' for more information on SIPs

The document may help when you review the investment governance arrangements, since it will record the outcome of the previous review and the rationale behind it.

Financial and non-financial factors

The Law Commission has produced guidance on how trustees should consider financial and non-financial factors. In summary:

- ▶ You should take into account factors which are financially material to the performance of an investment.
- ▶ Where you think environmental, social and governance (ESG) issues are financially significant you should take these into account. Likewise if you think certain ethical issues are financially significant.
- ▶ While the pursuit of a financial return should be your main concern, the law is sufficiently flexible to allow you to take other, non-financial concerns into account if you have good reason to think that scheme members share your view and there is no risk of significant financial detriment to the fund.



You can find the Law Commission guidance at:
<http://bit.ly/FidDuties>

Sustainability

You should bear in mind that most investments in DC schemes are long term and are therefore exposed to the longer-term financial risks. These potentially include risks relating to factors such as climate change, unsustainable business practices, unsound corporate governance etc. These risks could be financially significant, both over the short and longer term.

You should therefore decide how relevant these factors are as part of your investment risk assessment. You could ask your investment manager(s) and investment adviser for help with this.

Once you have considered the longer-term sustainability of your investments, you may wish to take action. This could include making changes to the investment portfolio, or engaging with the companies in which you invest.

Other non-financial factors

You may wish to offer members funds that take non-financial factors into account. These could include funds that select investments according to particular religious principles, or based on environmental or social principles.

Investment stewardship

For most pension schemes, stewardship activities, including engagement, are likely to be undertaken by the investment manager on the trustee board's behalf. This especially applies where investments are made via pooled funds. We would encourage you to become familiar with your managers' stewardship policies and where appropriate, seek to influence them. For some schemes a formal scheme stewardship approach may be appropriate (eg by following the principles set out in the UK Stewardship Code – see link below), particularly where your scheme holds a significant amount of assets.

Good stewardship includes the exercising of rights attaching to investment, such as the voting rights attached to shares. Where practicable you may wish to agree specific voting criteria with your investment managers. Services that provide analysis and voting recommendations are available and can assist you in setting criteria. Where you don't agree specific voting criteria with your investment managers, you might still wish to ask them questions like:

- ▶ Who is their proxy voting adviser?
- ▶ How often have they disagreed with their adviser's recommendations, and are there any particular issues on which they consistently disagreed?
- ▶ Are there any instances where they did not cast votes at all – for example in specific markets – and why?

Useful links

- ▶ Information on quality engagement between institutional investors (which includes pension schemes) and the companies they invest in is available from the Financial Reporting Council's (FRC) pages on the UK Stewardship Code: <http://bit.ly/FRCStew>
- ▶ The Association of Member Nominated Trustees (AMNT) has developed The Red Line Voting initiative to enable pension schemes to take a more active asset ownership role: redlinevoting.org

Further information on the quality of engagement and reporting by asset managers may also be found at:

- ▶ UN Principles for Responsible Investment transparency reports: <http://bit.ly/UNPRI/>
- ▶ Share Action reports: www.shareaction.org/research

Your scheme's SIP is required to include (among other things) statements about your policy (if any) on voting rights, and the extent to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments.

You may wish to expand these statements into meaningful policies on longer-term sustainability, how you apply the principles of the Stewardship Code, and how you will take non-financial factors into account.



See the guide on '**Communicating and reporting**' for further information about the SIP and general guidance on communicating with members.

Setting objectives and strategies

When setting investment objectives you need to consider how the needs of your members might vary when they are paying money in (the accumulation phase) and when they are accessing their benefits (the decumulation phase).

Accumulation phase

The age of members within a scheme will vary; while some may be very close to retirement, others may only have started a career and have many years to go to retirement. These members may have very different expectations for how they would like their funds invested.

For example, older members may wish to hold more stable investments that expose their accumulated capital to less volatility, whereas younger members may wish to hold higher risk investments that are expected to deliver higher returns over the longer term.

Decumulation phase


Individual members may take their benefits as cash, income drawdown, pension annuity or a combination of these. When setting objectives you need to consider the form of benefits members are likely to take and the age at which they intend to take them.

How a member's fund is invested in the years leading up to the benefits being accessed will be influenced by the way they are likely to be accessed.

Designing investment arrangements (including default arrangements)

Understanding your membership

You need to understand the needs of your membership, and how these might change in the future, so that you can define your objectives and set an appropriate strategy. You can gather information from a number of potential sources. Some examples of these are set out in the table below.

Source	Information
Administrator/provider	<ul style="list-style-type: none"> ▶ Basic information on membership, age, intended retirement date, etc ▶ Trends in scheme data, for example, increase in proportion of cash being taken as benefit ▶ Trends in industry (based on their data), for example, changes in retirement dates
Scheme members (see Know your members and seeking their views in the guide on 'Communicating and reporting') 	<ul style="list-style-type: none"> ▶ Benefit preferences ie cash/pension drawdown/pension annuity ▶ Risk appetite ie low/medium/high ▶ Preferences regarding non-financial factors and preferences regarding socially responsible investment ▶ Degree of financial knowledge ie low/medium/high and preference for more complex investment options ▶ Other pension benefits
Advisers	<ul style="list-style-type: none"> ▶ Analysis of scheme membership ▶ Industry trends, eg structure of benefits required
Employer	<ul style="list-style-type: none"> ▶ Employer strategic objectives for scheme, as part of their reward package, for example, basic provision or market leading provision ▶ Prospects for employer, for example, future recruitment, etc
The Pensions Regulator's website	<ul style="list-style-type: none"> ▶ Trends in industry, eg changes in retirement dates, benefit preferences, etc

Understanding your membership continued...

When assessing your membership characteristics you may use regular reports from your administrator or provider. Where these do not include enough detail, you may need to ask for bespoke reports.

There is currently not a great deal of widely available data to help you predict the retirement choices members might tend towards, in light of the pension flexibilities now available to them. Members' views may be sought but they may have no firm view themselves. However, as more members use the flexibilities now available to them, the structure of the benefits they take may change. You may choose to take the trends in members' choices into account by analysing the behaviour of members through the scheme data and the ways in which they choose to access their benefits. In addition, you may wish to supplement your views with those of your administrators and providers and by observing wider market trends for similar organisations.

Interpreting the data

You may have gathered a large quantity of data or it may be incomplete (particularly where the level of member engagement is poor) so you may be uncertain about likely future trends or preferences. In most cases you will need to use your own knowledge and judgement when making these decisions.

When analysing the information you have gathered you should be proportionate and consider the governance requirements involved. You may find it useful to identify groups of members with common characteristics, eg a similar attitude to risk or a preference for a similar type of benefit, and use that to help you decide whether to provide one or a number of default arrangement options for different groups of members.

Understanding your membership continued...

You can use your analysis to form high level objectives for your scheme's investments. As a simplistic example, for a default arrangement this might be of the form:

"We want members to be invested in a fund which:

- ▶ up to the age of 55 will seek to grow the members' assets with a medium level of risk
- ▶ from the age of 55 will seek to reduce the volatility to the members' benefits and will progressively switch the members assets equally between three funds:
 - **A cash fund:** to preserve capital and to meet the members' need for cash at retirement
 - **A bond-based fund:** to invest in assets which are broadly expected to match those which an annuity would be based on
 - **A lower risk growth fund:** to achieve a level of growth up until retirement which will then be used to fund the members need for income drawdown."

Implementing the objective

The next step is to select an investment structure that can deliver the strategy and enable the objective to be met. There can be significant differences between investment structures, eg in terms of risk, costs, investment flexibilities, services included and investment transition efficiencies. You should give appropriate consideration to these factors as part of the selection process.

Available market options

For some schemes, particularly those where available resources for administration support, investment advice and governance time available are limited, you may wish to consider a range of 'off-the-shelf' options (eg target date funds) which are available in the market. These may also be suitable where employers only wish to provide a basic arrangement as part of their pension provision. Some possible sources of information are outlined in the table on page 13.

Available market options continued...

Source	Information
Insurer/Product provider	<ul style="list-style-type: none"> ▶ The range of available 'bundled' services where investment, administrations and other services are included
Investment manager	<ul style="list-style-type: none"> ▶ Investment management options ▶ Dedicated funds which de-risk the members' investments and align them towards their chosen benefit structure as they approach retirement
Administrator	<ul style="list-style-type: none"> ▶ The range of administration and other services where in-house support is unavailable or an unbundled approach is used
Investment consultant	<ul style="list-style-type: none"> ▶ Advice on range of market options and on costs, benefits and risks, etc associated with different approaches ▶ How investments can be blended to form a strategy ▶ Information about platforms which can give access to multiple fund managers
Other sources	<ul style="list-style-type: none"> ▶ The Pensions Regulator/PLSA for information and guidance on what you should consider

When considering how you might implement a strategy and achieve your objectives for the scheme, you should also take account of:

▶ **Developments in investment approaches, products and solutions**

The pace of developments in this area is rapid. New types of fund may be developed which may offer alternative ways of achieving your objectives. For example:

- Funds that seek to control risk and generate more stable returns, eg diversified asset funds
- Funds that embed investment de-risking decisions, eg target date funds

▶ **Implementation costs**

Designing and implementing a new default strategy involves costs and imposes demands on your time and your governance budget. You should make a distinction between those costs which can:

- add value to member outcomes, for example, where the benefits of moving to a new product or fund strategy which offers better risk adjusted outcomes or a more appropriate level of risk outweigh the costs
- diminish member outcomes, for example, where the costs to move between different funds outweigh the benefits, or through applying excessive fund charges

▶ **Implementation governance**

You should consider the immediate and ongoing governance and cost requirements of different implementation options. Some strategies can be more difficult to implement and the ongoing requirements for monitoring and investment/administration input, eg in relation to switching funds to rebalance members' funds, can be much more onerous.

▶ **Asset liquidity and dealing frequency**

Most members will not have a need for immediate liquidity of their investments, and it may not always be beneficial for dealing to be carried out daily. You should think about the level of liquidity that your members need, eg in relation to likely transfers from the fund, and in that context, consider the liquidity constraints on certain fund structures. You should seek to balance the liquidity of assets against the investment objectives. Holding too high a proportion of liquid assets may impact the level of investment return, and limit opportunity for diversifying your portfolio of assets.

▶ **Allowing for the future**

You should think about how the arrangement implemented could cope with future changes, such as:

- **Membership:** if the number of members change significantly from that expected will the arrangement still be appropriate and can it be altered relatively easily
- **Investment:** investment markets change and investment products and techniques evolve. Consider the ability of the scheme, for example, through a platform, to access new products or fund structures using different techniques
- **Organisational:** Employers and providers can change dramatically. You should consider what would happen if the employer were to grow, stagnate, be taken over or decline. What would happen to the arrangement in the event of the employer failing? How your scheme would cope if providers undergo change, eg if a provider decides to withdraw from a particular market.

Bespoke arrangements

If your scheme needs a bespoke arrangement (eg a 'white-labelled' arrangement) to meet specific requirements for the membership you will need to take more advice on these types of products. In each case you should document a clear explanation of their strategy and objectives and how you expect them to be achieved by the implementing that arrangement.



Additional fund options

For many schemes, a single default arrangement or limited series of default arrangements will be enough for their membership. However you may decide to make an additional range of funds available from which members can select. The number of fund choices that you offer to members may be influenced by:

- ▶ The views of the employer, eg the desire to offer a market leading pension product as part of their recruitment policy or the need to offer investments that accord with its own corporate responsibility policy
- ▶ The governance budget, in terms of time, expense and resource of the trustee board. For example, the more limited this is the less time that you will have to monitor and review additional funds options in addition to the default arrangement
- ▶ The needs of the membership. For example:
 - Financial implications of environmental, social and governance factors
 - Ethically focused investment
 - The wish to take their benefits in a different form and at a different date to that targeted by the default arrangements
 - A desire, by those with more financial knowledge, to manage their own pension portfolio
 - Tolerance to risk. For example, members with substantial other assets or pension savings may have a much higher tolerance of risk than that included in the default arrangement

Fund selection

When selecting individual funds you should devote enough time and resources to:

- ▶ Understanding the objective of each investment fund.
In particular the:
 - level of risk in the strategy and in the underlying investments and the ways in which those risks are measured and managed
 - investment objective and (net) expected return of the investment manager and the way in which the manager seeks to achieve that, eg by active or passive management
- ▶ Understanding the basis upon which the total level of costs and charges is calculated and levied on each individual fund. You should consider:
 - how ongoing costs, charges and transaction costs can erode the value of member accounts
 -  See the guide on **'Value for members'** for information about charge controls and transaction costs.
 - the need to report on charges and transaction costs in the chair's annual governance statement.
 -  See the guide on **'Communicating and reporting'** for information about the chairs' statement.
- ▶ Completing enough due diligence in selecting platforms and providers. You should make sure that any adviser you use to assist you with this task has appropriate experience in this area.
- ▶ Ensuring that the number and risk profile of investment funds offered as an alternative to the default arrangement(s) reflects the needs of the membership.

See Appendix 1 for information about investment mapping and the definition of a default arrangement.

Documentation

You should ensure that you document the information appropriately so that you can use it to assess whether the performance of the fund(s) is in line with the objectives and continues to remain suitable for members.

Impact investment

Impact investment (sometimes referred to as social and/or environmental impact investment) aims to deliver tangible positive impacts on society and the environment alongside generating investment returns. Typically, the positive impacts address basic societal and environmental problems such as food production, the provision of clean drinking water and health care. Impact investors expect companies and enterprises to measure and report their wider impact on society and hold themselves accountable for delivering and increasing positive impact.

Impact investments have a range of objectives, strategies and approaches to investment, governance, impact measurement, monitoring and reporting. Assets range from large-scale infrastructure projects, to social housing, to companies with a specific social aim. Investment structures can be anything from listed equities and bonds, to private equity allocations, to bonds with a specific purpose.

Some less liquid investments, which may include investments referred to as patient capital, can form part of an impact investment approach. You may consider such an allocation for diversification, positive risk adjusted returns and higher yielding long duration inflation-linked income streams.

The impact of investment decisions is a subordinate concern to the primary purpose of pension investing, which is delivering an appropriate return. There is, however, no barrier to investments that have a social impact as a by-product where that primary purpose is met.

Trustees can also choose to actively take account of impact considerations in making an investment decision where they have good reason to think scheme members share their view and there is no risk of significant financial detriment to the fund. They should not choose impact investments where there is a risk of significant financial detriment to the fund.

Risks can include liquidity and a lack of common standards. You should consider these areas with your investment adviser when considering allocations to impact investments and how the investments would affect the security, quality, liquidity and profitability of the portfolio as a whole.

Patient Capital

Patient capital investment involves the provision of long term finance to high potential firms to enable them to reach their full potential. Investment is typically directed towards start-ups which are looking to up-scale and/or innovate but might also be needed by more established businesses which are looking to achieve next-level growth. In practice, many of these investments are likely to be targeted towards capital intensive R&D businesses, businesses with long product development cycles or businesses with innovative technologies or significant intellectual property needing access to growth funding.

These investments are typically illiquid and would represent a small proportion of a pension fund's overall asset allocation. Patient finance investments offer the potential to benefit from longer term outperformance through:

- ▶ Investing in an inefficient market - which is (currently) fragmented and underdeveloped
- ▶ Enabling businesses to up-scale and achieve transformational development
- ▶ Eliminating short-term financing constraints and enabling management to focus on business development, optimisation of value creation and optimisation of any future business disposal strategy

If you are considering patient capital investment, you need to complete sufficient due diligence before investing to ensure you properly understand the main drivers of the expected return and how risks are managed and mitigated. You also need to consider the suitability of the scale, expected time horizon and illiquidity of the investment in the context of your scheme's objectives and Member profile.

Strategy and performance monitoring and review

The DC code sets out the circumstances when you must review your SIP, default strategy and performance of the default arrangement.



See the guide on ‘**Communicating and reporting**’ for more information.

One of the circumstances is when there are significant changes to the demographic of the membership.

What you decide is significant will be relative to the size and existing demographic of each scheme, but examples of significant demographical changes might be:

- ▶ a bulk transfer (eg following a merger or an acquisition) in to or out of the scheme which significantly changes the average age of the scheme membership or a particular cohort of members.
- ▶ a significant increase in the proportion of members tending towards or away from a particular method of accessing their benefits (eg there is a significant reduction in the number of members wishing to access their benefits as cash).
- ▶ a significant increase in the average contribution paid by the members or a particular cohort of members, where this was not already factored in to setting the strategy.
- ▶ a trend towards consolidating previous pots within the scheme which increases the average pot size of members or a particular cohort of members.

Unless your scheme’s membership is very diverse and changes frequently, you are unlikely to need frequent and in depth analysis to assess whether the scheme demographic remains consistent with the investment strategy initially set. However, you should keep an eye on changes in membership (eg through your administration reports), and seek to carry out a full analysis at least every three years or without delay after any significant change in the demographic profile of the relevant members.

Fund and strategy performance

You should regularly review the longer term performance of individual funds against the fund benchmarks and the net outperformance targets.

It is important to consider how the performance has impacted different members or groups of members, since members will be on varying 'flight paths'. For example, the fund performance may be on or exceeding target in relation to members that are within ten years of their expected retirement date, but for members with 20 or more years to expected retirement date the performance may be below target. There are commercially available index providers, whose indices you might consider appropriate to help you monitor your scheme's investment performance. Other, more bespoke performance monitoring services are also available.

Where the investment performance fails to meet the longer term performance objective, you should seek to understand why. In addition, you should consider any organisational change at the investment manager firm, and regularly review whether the provider is likely to deliver their expected level of performance over the longer term.

You may wish to consider setting automatic review triggers based on the level of net performance of investment funds against their benchmarks or objectives. Any 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 whereas an actively managed fund may merit triggers configured more loosely around its long-term performance objective.

Fund scale

You are likely to find it helpful to build flexibility into the investment review and assessment of arrangements. You should pay more frequent attention to investment funds that hold a significant proportion of scheme members' assets, including the investment funds which underpin the default arrangements. You should also consider whether a significant increase in asset scale could enable fee scale discounts to be achieved.

Self-select options

You should periodically review the range of self-select investment funds available to members to ensure that the funds remain relevant to the members' objectives. You should also regularly review the performance of the self-select funds used by members against their performance objectives and against industry benchmarks where available. Again, it is important to consider the impact of the fund performance on different members or groups of members.

Market developments

As with designing your investment strategy, you, together with your advisers, should be mindful of market developments that may enable you to meet your scheme investment objectives or manage your members' investment risks in a more efficient and cost effective way. The costs involved in changing funds can be significant. You should always consider the long-term nature of pension scheme investments and not take decisions based solely upon short-term performance.

Form of review

Your review may take different forms, eg using manager or adviser reports, or meetings with the managers or advisers. When reviewing and monitoring fund performance, we suggest that you:

- ▶ 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 this affects the net return which members receive: you should check the level of fees against appropriate market comparators to ensure they remain competitive



See also the how to guide on 'Value for members'

- ▶ monitor the levels of portfolio turnover and the associated transaction costs, and consider whether these are justified 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 you to potential risks
- ▶ regularly assess the effectiveness of your investment decision-making and governance process, make improvements to the process as appropriate and report to interested parties (including members).

Changing investment funds

The costs involved in transitioning investments to a different investment fund or manager can be very significant and you should consider these costs (and the ways you can mitigate and manage them) when making your investment decisions. In particular, you should bear in mind that the explicit (visible) costs in a transition can be far less than overall costs. You should seek to understand the transition options available and take appropriate advice. Common mitigations against out-of-market risk and other transition costs include:

- ▶ in specie transfers where the assets are simply reregistered rather than traded
- ▶ pre-funding which reduces the time investments spend out of the market
- ▶ undertaking phased selling to reduce the adverse impact that selling may have on price and average out the market conditions over which it occurs

You should ensure that the transfer of investments and cash between the parties is reconciled after transition.

Guarantees and promises

Some charge controls do not apply to arrangements which contain third-party promises, or guarantees about the level of benefits members will receive. You should assess whether any guarantees or other favourable treatment might be lost on transition and whether any penalties will be triggered.



See the guide on 'Value for members' for more information about charge controls

Member notice

You should generally inform members before any fund transfer so that they can switch to a different fund if they do not want their investments to be automatically moved to the new fund (see Appendix 1 for information on investment mapping). Most transitions will also result in a black-out period when members will be unable to view or alter their accounts and you should communicate this to members.

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

Security of assets

Establishing the level of protection that different scheme assets would have in the event of fraud, malfeasance or other adverse events is not a straightforward task. You may not always be able to definitively establish the extent to which your scheme's assets are covered.

The Financial Services Compensation Scheme (FSCS) may provide some protection, but there are no definitive criteria for establishing the extent to which a scheme is covered; the FSCS confirm coverage on a case by case basis. You can contact the FSCS helpline (0800 678 1100) to discuss your own arrangements and to ascertain the level of protection the FSCS might provide, and under what circumstances.

There are mechanisms that may cover some or all of a scheme's assets outside of the FSCS, and this will depend on the structure of the scheme's investments and how they are held. It is likely that you will need to take advice to establish the levels of cover, and you may also need to take professional advice on the overall extent of coverage the scheme has, and the level of risk that the scheme potentially remains exposed to.

You can then decide whether you are comfortable accepting that level of risk, or you need to make changes to the scheme's investments in order to reduce the level of risk. It is this conclusion and any planned actions that we consider it is best practice for you to communicate to members. You may wish to describe the range of protections that are applicable to the scheme's assets, and outline any advice you have received to inform your conclusion. You should be prepared to provide further information if members request it.



The Security of Assets Working Group has produced a guide for trustees to help them understand the risks that their scheme's assets may be exposed to, and questions they can ask their providers and advisers to help them establish the level of protection and therefore the level of residual risk. This guide can be found at: amnt.org/policy-and-research/dc-assets/

Appendix 1: Default arrangements

There are different definitions of 'default arrangement' used in legislation, which vary for different legal requirements. In this guide the term means arrangements into which members' contributions are invested if they do not choose their own investments. Schemes being used for automatic enrolment must have at least one default arrangement. If your scheme has a diverse membership you might decide that more than one default arrangement is appropriate.

Definition

Broadly speaking, the difference between the two definitions is that for the charge cap, it relates only to arrangements in schemes being used for automatic enrolment. For governance standards the definition also includes schemes which are not being used for automatic enrolment. Some exceptions and exemptions apply, and you may need to take advice to establish which arrangements in your scheme meet the different definitions.



You should read the DWP's guidance on the charge controls in relation to the restrictions on charges as this includes a section on identifying default arrangements. See: <http://bit.ly/ChargeCtrls>

When reading the guidance, trustees should note that whether the scheme is used for automatic enrolment purposes is not relevant in the context of requirements to comply with the governance standards, including the requirement to produce a SIP relating to default arrangements.



See the guide on '**Communicating and reporting**' for more information about SIPs.

Investment mapping

Some schemes have arrangements in place where mapping exercises take place, or have taken place in the past. This is where the trustee board has changed the investments available to the member and the members assets are 'mapped' to the new investments. This may be because the investments in which members' funds were held are no longer offered, or the trustee board no longer considers them appropriate.

The result of such exercises is that a member may now be investing in a fund that they have not chosen to invest in, even though they made a choice to invest in the original fund which has now been mapped to a different fund. A similar situation could also arise due to 'white-labelling', where members choose a type of fund or investment they want their contributions to go to, but the trustee or investment manager decides which particular investment to use.

This may mean that the arrangement falls into the definition of a default arrangement which is subject to charge controls.



See the guide on '**Value for members**' for information about the charge controls.

To establish whether this is the case, you will usually need to refer to information supplied to the member at the point they originally chose to invest, and any subsequent relevant information, to establish whether the member had signed up to a particular investment approach or to a particular fund. Examples of things you may wish to consider are:

- ▶ whether the communications disclosed the possibility that the arrangements underlying the choice of investment may be subject to change, or
- ▶ whether members were informed in advance that changes to the arrangement were going to be made, and were given the opportunity to actively choose to switch to the new arrangement as nominated by the trustees.

This will assist in forming a view as to whether the member 'chose' to invest in the new arrangement. Where it appears that the member did not choose to invest in the new arrangement, it should be treated as a default arrangement.

Appendix 2: Example table of accountabilities

Based on the table of accountabilities produced by the Investment Governance Group

	* with input from professional advisers and providers as appropriate ** with input from employer, advisers and providers as appropriate	
	Investment governance decision (or process)	Decision-maker for trust-based schemes
Governance structure	Appointment of trustees	Employer*
	Consider establishing an investment sub-committee	Trustees*
Objective and strategy setting and design of arrangement	Selecting the provider/adviser and agreeing investment governance process	Trustees**
	Scheme design: investment principles etc	Trustees**
	Selecting the fund range, including the default option	Trustees**
Monitoring, review and change	Compliance with, and ongoing monitoring of, legal and regulatory requirements	Trustees plus investment advisers, lawyers and auditors
	Monitoring and reviewing investment performance of the funds	Trustees**
	Reviewing (and changing) provider/adviser and fund range	Trustees**
Communications to members	Communication to members on investment choices, performance, retirement options etc	Trustees**
	Review communications to members	Trustees**

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www.trusteetoolkit.com

Free online learning for trustees

To be read alongside our DC code of practice no. 13

A guide to Investment governance

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