

Ten becomes one: first phase of TPR's single code

September 2021

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Back in 2019, the Pensions Regulator announced that it intended to combine its existing codes of practice as a means of complying with the requirements of the second European Pensions Directive, better known as IORP II.

With its consultation ultimately delayed for obvious reasons, TPR finally issued draft documents in March this year – the new code was originally intended to come into force in November 2021.

Given the scope and potential impact of the code, this timetable has recently been pushed back to allow TPR more time to fully consider consultation responses. The upshot is that the code is now unlikely to be laid before parliament before spring 2022, and to be in force until summer that year.

Nonetheless, TPR will expect “governing bodies” (the new overarching term for trustees or managers of occupational pension schemes or, for public service schemes, the scheme manager and the pension board) to be up to speed from the off.

So despite the delay in TPR's timetable, schemes should continue engaging with the draft code's contents, although bearing in mind that some change is probably on the cards.

All change?

At first blush, the draft single code looks very different to its separate predecessors. While, for the most part, familiar terminology is used, TPR has moved away from the titles of its original codes. Instead, we now have five sections:

- the governing body
- funding and investment
- administration
- communications and disclosure
- reporting to TPR.

Each of these sections divide and subdivide, ultimately providing 51 new ‘modules’ that bring together 10 of TPR's 15 current codes. Apparently, this has reduced the page count by nearly a half.

Most of the content is a reworking of the previous codes, hence the regulator's view that governing bodies should be in a position to comply immediately. However, some items are new and there is greater detail on several topics, such as cyber security.

What's new?

The key difference is the long-awaited detail of how schemes should establish and carry out the processes required by the Occupational Pension Schemes Regulations 2018, which came into force on January 13 2019 and implemented the IORP II requirements.

Subject to certain exclusions (including authorised master trusts), the regulations require occupational pension schemes to establish and operate an effective system of governance, including internal controls.

The system of governance must be proportionate to the complexity, scale and organisational structure of the scheme, and to the nature of the risks to which it is exposed, and, if the scheme has more than 100 members, assessed by the trustees in a documented “own-risk assessment”.

In addition, the single code contains new modules on matters including stewardship and climate change, and new modules are usefully highlighted in an appendix to the consultation.

However, TPR has not indicated where it has made changes to its drafting and/or where its emphasis differs to that of the legislation.

One notable example in the initial draft was in relation to the statutory requirements on occupational pension scheme investments. The 2005 regulations require schemes’ assets to “consist predominantly of investments admitted to trading on regulated markets”.

In contrast, the draft single code stated that “no more than a fifth of assets should be traded on non-regulated markets (except in exceptional circumstances)”.

Like many others, in our response to the consultation we asked TPR to ensure that it draws attention to areas where its stance has evolved and/or diverges from the legislative requirement.

In an interim response published in August, the regulator noted that it will not proceed with the above proposal, at least not as currently drafted.

Code brings new terminology

TPR has adopted “government communication principles”, with the aim of helping users to distinguish between legal duties and its expectations.

In the new code, legal duties are shown by the use of the word “must”, while TPR’s expectations are indicated by the word “should”.

The regulator uses “need” where there is no expectation or legal requirement in place, but it considers that a process is necessary to allow a scheme to operate.

However, aspects of TPR’s drafting are less clear. In one new module, it refers to a scheme’s implementation report. There is no such document. It appears to mean a scheme’s investment report (part of its annual report and accounts).

For schemes that are required to produce a statement of investment principles, this investment report must include an implementation statement.

Further, in the module on information to members (part of the communications and disclosure section), it refers to “statutory financial statements”. This is not terminology many would associate with annual benefit and summary funding statements.

We have therefore suggested that TPR sticks to terms in current usage. Otherwise, the document will not be as user-friendly as it hopes.

Schemes will need more adviser support

None of TPR’s existing codes of practice are intended to cover all aspects of pensions legislation, and trustees/managers are expected to look beyond them and seek the help of advisers to understand all their legal obligations. That remains the position for the new single code.

However, we are concerned that, if it remains as drafted, governing bodies will need more support from advisers than is currently the case.

In the process of shortening the code, and rendering it more generic, some of the useful detail has been removed. In particular, this occurs in the explanations of exceptions or exemptions to requirements, as well as the underlying requirements themselves.

Even those who are very well-informed are unlikely to have such information at their fingertips. This will mean they will need to turn to their advisers more frequently to check which modules are relevant and what the actual legal requirement is (as it acknowledges, TPR's best practice examples will not be appropriate across the board).

Obviously, this will be a significant challenge for those schemes that are less well-resourced. In some cases, there will be no budget for additional checks, so trustees/managers will need to do their best to fit together the code, legislation and guidance in order to create the full picture.

In a similar vein, it is not easy to discern which modules apply solely to public sector schemes and, to a lesser extent, authorised master trusts.

We are hoping there might be a technical solution that will allow schemes to select an appropriate view of the new code, which would remove, or grey out, any modules (or sections of modules) that do not apply.

TPR's interim response does acknowledge this feedback, noting that it intends to explore ways to make the audience for each module clearer.

The effective system of governance

As noted above, the effective system of governance and the own risk assessment elements are completely new.

According to the draft code, a "system of governance will include anything that can reasonably be considered part of the operation of a pension scheme.

Internal controls are a key feature of any system of governance and are:

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

TPR lists the modules that contain systems, arrangements or procedures which trustees should have in place to comply with the requirements for internal controls, as well as for the overall ESOG.

For example, for 'management of activities', governing bodies should refer to:

- the role of the governing body
- meetings and decision making
- remuneration policy
- working knowledge of pensions
- governance of knowledge and understanding
- building and maintaining knowledge
- dispute resolution procedures
- continuity planning.

Despite these lists, it is not entirely clear from the draft code which elements form part of the ESOG and, if they are part of it, whether they are relevant for all schemes or only those with 100 or more members. Ideally, TPR would provide a table that sets out this information.

The own risk assessment

The ORA is an assessment of how well the trustees' governance systems are working, and the way potential risks are managed.

Although the regulations require TPR to set out the timing of the first and subsequent ORAs in its new code of practice, the timing they allow for is more generous than the regulator proposes.

Under the regulations, the first ORA must be prepared within 12 months from the last day of the first scheme year that begins after TPR has published the necessary codes of practice, or, if later, within 15 months of the date on which the trustees are next required to obtain an actuarial valuation, or by the date on which the trustees are next required to prepare a chair's annual governance statement.

Subsequent statements must be prepared at intervals of not more than three years.

In contrast, the draft code suggests that TPR expects trustees to carry out and document their first ORA "within one year of [the draft code] coming into force", and subsequent ORAs to "be carried out and documented within 12 months of the last" and to be "reviewed whenever there is a material change in the risks facing the scheme, or to its governance processes".

We understand that TPR believes an annual ORA will result in the assessment embedding in trustees' processes and, ultimately, make it less onerous to undertake.

Its use of the word "should" as opposed to "must" does indicate that this is not a legal requirement, but we note that trustees should avoid deviating from its expectations unless they can demonstrate it is not possible or appropriate for the scheme to meet them.

In its interim response, TPR stated that the ORA should be prepared in a "timely fashion", with the legislative timescale seen as a maximum. However, following feedback, it will consider how often trustees should review the ORA, and whether any guidance or further changes are necessary, particularly for smaller schemes.

We are concerned that requiring the first assessment too quickly, and during a period where trustees are assimilating many other changes (scheme funding, climate change reporting, etc), could prove a major challenge for many.

Overall, trustees should consider auditing their governance systems and processes now, based on the draft code, and start addressing any gaps.

