

Briefing

Preparing for the combined Code

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The Pensions Regulator (“TPR”) is consulting on a new combined Code of Practice (“the Code”) for pension scheme governance and this will result in the introduction of some new requirements for trustees.

The new Code will incorporate the Governance Regulations introduced in 2018¹ (“the Regulations”) and will combine 10 of the current Codes of Practice into a single pensions governance handbook.

We take a look here at what this means and the actions you should think about taking now if you are responsible for running a private sector occupational pension scheme.

Every item on a typical trustee meeting agenda is essentially a form of governance and risk management. TPR guidance already highlights a clear link between integrated risk management and better outcomes for members. It is reasonable to apply the same logic to the rest of TPR’s guidance; better scheme governance results in better outcomes for members.

Effective system of governance

In an update from the existing need to have internal controls, the Regulations require trustees to establish an effective system of governance, including internal controls, that is proportionate to the size, nature, scale and complexity of the activities of the scheme. Trustees will be required to have a risk management system comprising strategies, processes and procedures, and involving independent input from their advisers as appropriate, to identify, measure, monitor, manage and report risks.

Some trustees will be asking “So what does this mean for me?” or “How is this different from the risk register we already have in place?”.

To meet the requirements of the Regulations you will need to identify the risks specific to your scheme, evaluate and document the systems and processes in place to manage them and decide whether they provide you with clear oversight in order to manage the risks on an ongoing basis. For example, it will be necessary to determine who is responsible for managing each risk and the way in which this happens, whether there has been any failure in systems or processes, and the steps taken to prevent reoccurrence or enhance the monitoring of that risk.

Each trustee board is different and for some the solution will be to establish a governance committee to ensure a dynamic structure for managing their risks.

¹ The Occupational Pension Schemes (Governance) (Amendment) Regulations 2018

Establishing regular reporting metrics will also provide transparency and the evidence required to demonstrate that trustees are actively managing a scheme's risks. Some trustees may decide it is appropriate to establish an information-sharing protocol with the employer and agree provision of regular reporting on key performance indicator metrics by the employer to demonstrate the steps they are taking to manage covenant risk.

So what are the benefits to schemes of these changes?

Once established, the governance framework and regular monitoring metrics should lead to greater efficiency and improved decision-making, ultimately enhancing the trustees' effectiveness. This should help trustees to identify priorities and ultimately provide more time at meetings for discussion of key issues.

Focus on what is material

Trustees should also consider financial materiality in order to use meeting time wisely. For example, are they spending too much time debating the performance of an investment manager at the expense of focussing on high-level strategy?

Many will have experienced it taking several quarterly trustee meetings to implement a change in investment strategy or replace an investment manager. In fact the second highest rated investment risk in our [Top Pensions Risks - 2020 Vision survey](#) was a lack of a framework allowing the trustee board to act quickly, with 60% of respondents rating this as risk for their scheme. However, by adopting a more dynamic approach, perhaps within a sub-committee structure, and using virtual ad-hoc meetings, the time it takes to implement such changes can be significantly reduced.

Own risk Assessments

To ensure risk management is integrated into all management processes and decision-making, trustees of schemes with 100 or more members will need to focus on all the risks faced by their scheme and use that analysis to produce and document an Own risk Assessment (ORA).

All schemes will have 12 months from the date the Code comes into force to prepare and document their first ORA. The ORA should then be reviewed annually, or when there is a significant event that affects the risks facing the scheme.

We believe the ORA should consider risk in the context of the short, medium, and long-term impact for the scheme. In our view it should also include material strategic financial and reputational risks, as well as operational risks, especially focussing on those associated with outsourced activities and cyber risk.

Several points which have to be included in the ORA are detailed in the Regulations. These include the way in which the trustees assess new or emerging risks where environmental, social and governance (ESG) factors are considered in investment decisions. Trustees will also need to describe how the ORA is used in their management and decision-making processes, including focus on managing risks associated with outsourcing and where the sponsor carries out certain functions in house.

Our view is that the ORA should cover the trustees' tolerance to each of the risks they identify, record the results of their analysis and set out clear lines of responsibility for the management of these risks. As mentioned, we believe having meaningful key monitoring metrics in place will be helpful. Trustees should avoid the temptation to get bogged down in the detail rather than focussing on the high-level activities that make the difference in ensuring a scheme is well managed.

Assessing and managing risk

We found from our recent [Top Pensions Risks – 2020 Vision survey](#) that most schemes took a fairly simple approach to managing risk.

77% of schemes had a simple risk register in place, with just over half (52%) using simple risk impact and likelihood scoring to assess and manage risk

62% of participants made use of risk monitoring and reporting



half of those surveyed had a risk management policy in place for their scheme.



of those running schemes used key risk indicators to give early warning signals on how specific risks develop over time

26% had a formal risk oversight committee in place



undertook deep dives into key specific risks



made use of dedicated risk management or governance software to help monitor and manage their scheme's risks

The new requirements reflect TPR's ambitions for trustees' management of their schemes and the risks they face to become more dynamically focussed on their own scheme circumstances. Trustees should adopt a proportionate approach that reflects the size and the activities of their schemes, which means that different approaches will be suitable for different schemes. As mentioned in relation to the ORA, some of the new requirements only apply to schemes with 100 or more members. Of course trustees of smaller schemes may still choose to follow the same approach, or those elements of the ORA they feel are most relevant to them.

However, the central message is clear – trustees will generally need to focus on “upping” their game when it comes to identifying and monitoring the material risks faced by their scheme.

In the past, regulations focussed on establishing governance mechanisms and setting out what good governance might look like. Now the emphasis is on demonstrating the effectiveness of governance, how it is aligned with strategic goals or objectives, and how progress against these objectives is monitored and managed. This is essentially the approach taken by successful companies to manage their risks and develop their controls to support achievement of their objectives. In fact, the ORA bears a striking resemblance to the risk self-assessment requirements within the corporate and insurance worlds.

Facilitating good governance

Maintaining positive and open relationships with external advisers is paramount. Trustees should not underestimate the role of professional advisers in ensuring meetings are well governed. Structured agendas, which ensure the necessary amount of time is devoted to discussing the most pertinent matters at hand, and focussed adviser papers which are circulated and read in advance, will help ensure a board is conversant in the matters for consideration at each meeting. This, in conjunction with a competent scheme secretary who manages the meeting process, produces detailed minutes and has ownership of an action log, will ensure that a board's activities are well organised. It will also help trustees focus on matters of strategic importance to help deliver the key objective of securing better member outcomes.

... A secure system of trustee record keeping, such as an online governance tool, or library, can be very helpful in ensuring that trustees can readily access their key governance documents.

Focusing on ESG

Achieving Net Zero by 2050 is already law in the UK and the resulting decarbonisation of the economy is already impacting on pension schemes. Right now is an opportunity for those running schemes to get a head start managing the risks stemming from climate change, as well as taking advantage of the opportunities coming from the transition to a low carbon economy. For many years TPR has been clear that schemes need to view ESG considerations in the context of an investment strategy as financially material; that is, something which if ignored will harm the long-term sustainability of a scheme's investments and, by association, the retirement outcomes of members.

Trustees therefore need to explain, as part of their effective governance of the scheme, how they have taken into account the risks this shift to the investment landscape could pose to their aims. This should not come as a surprise as over the last fifteen months we have seen the introduction of requirements to include firstly a trustee ESG policy, and then implementation of this policy, within the Statement of Investment Principles.

Other new requirements

For schemes with 100 or more members, the Regulations contain requirements for key functions such as risk management, internal evaluation of adequacy and effectiveness of the system of governance (internal audit) and actuarial.

The Code of Practice incorporates existing guidance on trustee remuneration and reflects the need set out in the Regulations for Trustees to set out a formal - and proportionate - remuneration policy which should be in writing. Remuneration policies will need to reflect TPR's increased focus on ensuring that conflicts of interest are appropriately managed.

Whilst TPR's guidance will be the subject of discussion over the coming months, trustees can take steps now to prepare the path for their implementation and start seeing the benefits of more effective governance.

What we can do to help you

Our consultants at Barnett Waddingham are well equipped to help you improve your governance with the overarching aim of obtaining better outcomes for your members.

We can help you to:

- understand and interpret the new requirements
- implement the changes in a way appropriate to your scheme
- review the effectiveness of your board
- implement any training requirements
- support new trustee induction
- test systems and processes (including cyber and data protection measures)
- establish continuity/crisis management plans
- track the interaction between funding, covenant and investment in real time and monitor your scheme's financial position using [Illuminate](#);
- integrate [ESG considerations](#) into scheme activity
- document all governance activity and communicate its benefits to scheme members

Ultimately we will provide you with the comfort that you have a best-in-class governed scheme which will not only satisfy the increasingly onerous requirements, but reassure members that their future income is in safe hands.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch via the following:

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