

What Do Trustees Need to Know About Investment?

Under law, there are certain duties that trustees must comply with when exercising their investment powers.

The Pensions Regulator (TPR) requires trustees to:

- Have knowledge and understanding of the principles relating to pension plan investment. Key investment issues are listed in TPR’s “scope guidance” of the trustee knowledge and understanding requirements.
- Have “working knowledge” of the plan’s Statement of Investment Principles (SIP).

What General Legal Duties Are Trustees Under When Investing?

In choosing any investment, trustees must (among other things):

- Invest *prudently*, as if they are under a moral obligation to provide for others
- Use the power of investment for the purpose for which it was given, which will usually mean investing in the beneficiaries’ best *financial* interests
- Comply with any *restrictions* on investment set out in the trust deed and rules of the pension plan
- Ensure the *security, quality, liquidity* and *profitability* of the overall investment portfolio
- Bear in mind the *nature* and *duration* of the future benefits payable under the pension plan
- Ensure the investment portfolio is *diversified* so as to avoid relying too much on any particular asset, issuer or group of undertakings
- Monitor the suitability of the default funds in the case of defined contribution plans and those with money purchase benefits such as AVC funds

For plans with fewer than 100 members the above is replaced by a simple obligation to have regard for the need for diversification.

Whom Must the Trustees Appoint and When Must They Take Advice?

Trustees must formally appoint an authorised investment manager, unless the plan is a wholly insured plan.

Before investing in any manner, trustees must take “proper advice” on the suitability of an investment having regard to their statutory obligations and the plan’s SIP. This applies even when making the move to a buy-in policy with an insurance company. The advice will usually be sought from an individual authorised by the Financial Conduct Authority (FCA). The advice must be in writing or confirmed in writing. It must address whether the investment meets the requirements of the legislation.

Trustees must also consider advice during the course of an investment. Trustees must decide how often and in what circumstances “proper advice” should be taken.

Legislation does not require trustees to take *legal* advice on any particular investment. However, latest guidance from TPR on both defined benefit and defined contribution (DC) investment governance recommends that trustees take legal advice in the area of investment management and we always suggest taking legal advice. This is particularly important where:

- The trustees are not investment experts or experienced in investment matters.
- The proposed investment forms a large proportion of the pension plan’s assets.
- The investment is of an international nature.
- The investment is complex. For instance, it is in derivatives or the investment does not trade on a regulated market. Similarly, if the investment is difficult to terminate easily without penalty, trustees should be aware of their rights.
- Trustees are being asked to give warranties and indemnities. These can expose the trustees to liability, which could exceed the pension plan’s assets.

Must Trustees Record Their Investment Policy?

Trustees must maintain a written SIP, covering:

- Their policy for complying with the legislation on choosing investments
- Their policies in relation to:
 - Kinds of investments to be held
 - Balance between different kinds of investments
 - Risks and how they are measured and managed
 - Expected return on investments
 - Realisation of investments
 - Financially material considerations (which include environmental, social and governance considerations)
 - Extent (if at all) to which non-financial matters (the views of members) are taken into account
- Their policy in relation to:
 - Exercise of the rights (including voting rights) attaching to the scheme's investments
 - Undertaking engagement activities in respect of the scheme's investments (including the methods by which, and the circumstances under which, trustees would monitor and engage with relevant persons about relevant matters such as performance, strategy, risks, etc.)
- From 1 October 2020, their policy in relation to any arrangements with asset managers

The trustees must review the SIP at least every three years. Further, the trustees must review the SIP if they make a significant change in investment policy. They must obtain "proper advice" before preparing or revising their SIP.

Trustees of occupational pension schemes providing DC benefits (excluding schemes where the only DC benefits are additional voluntary contributions) are required to publish their SIP in a publicly available format and, from 1 October 2020, will be required to produce and publish an implementation report. Trustees of schemes providing DB benefits will be required to publish their SIP from 1 October 2020 and to produce a shorter form implementation report from 1 October 2020, which must be published from 1 October 2021.

What Governance Requirements Should Trustees Be Aware Of?

Under legislation, but subject to any restrictions in their deed and rules, trustees have the power to make investments of any kind as if they were absolutely entitled to the assets of the pension plan. Employers will be interested in investment decisions and must be consulted over changes to the SIP. However, it is important to remember that the employer cannot limit the investment powers of the trustees in any way. Note, also, that no more than 5% of the plan's assets can be in "employer related investments" such as group company shares or property for the employer's business. Employer-related loans and employer-related transactions at an undervalue are prohibited.

TPR's investment guidance for defined benefit plans highlights the importance of trustees maintaining a sense of proportionality. They should identify those investments likely to have the greatest impact if they go wrong and focus their attention accordingly.

Trustees may delegate their investment powers to a sub-committee of two or more trustees. This is good practice where there are members of the trustee board who do not feel they have the required skills to make investment decisions.

For trustees of DC plans with default arrangements, the default arrangements and default funds must be reviewed at least every three years. Trustees must also review the default arrangements and funds after any significant change in investment policy or the demographic profile of the relevant members.

Conflicts of interests can arise between the trustees and the employer or the plan's investment adviser and investment manager(s). Under legislation, if the trustees identify a potential conflict of interest, they must still exercise their investment powers for the purposes for which they were given, which generally means in the sole interests of beneficiaries of the pension plan. Any conflict should be managed under the trustees' conflicts of interest policy.

What Formalities Must Trustees Comply With?

Trustees must follow certain formalities in appointing an investment manager as set out under section 47 of the Pensions Act 1995.

Trustees may be required to sign investment documents. Individual trustees must check who is authorised to sign documentation under their pension plan's governing documentation.

What Liability May Trustees Have for Investment Decisions?

Trustees cannot exclude or restrict liability for not acting with reasonable skill and care in their investment functions. However, the law absolves them from responsibility for investment decisions taken by an investment manager that is FCA-authorized and to whom they have delegated their investment discretion. This is provided that the trustees take "all reasonable steps" to satisfy themselves that the investment manager:

- Has appropriate knowledge and experience
- Is acting competently and complying with the legislation on choosing investments

Therefore, trustees should take professional advice when appointing investment managers and continue to monitor, with the benefit of professional advice, the performance of investment managers. They should also make sure that to the fullest extent possible the manager accepts responsibility for the delegated investment functions.

Some Practical Points

Stage	Required Trustee Actions	"Good Practice" Recommendations
Appointment of new trustee	New trustee must comply with TPR's knowledge and understanding requirements for investment.	Consider formal investment training for new trustees.
Appointment of advisers	Comply with Section 47 of the Pensions Act 1995 in appointing advisers and the CMA Order relating to the appointment of fiduciary managers and investment consultants.	Consider procedures for reviewing adviser performance and take advice on contract terms.
Preparing a SIP	Ensure SIP covers all matters set out in legislation. Take advice on the content of the SIP. Consult with the employer on the content of the SIP.	Consider taking covenant advice to help match the investment risk profile to covenant risk, in view of the plan's Integrated Risk Management policy.
Establishing good governance	Identify and manage conflicts of interest. Invest solely in accordance with the purpose for which the investment power was given, usually meaning in the best interests of the beneficiaries.	Consider whether to appoint an investment sub-committee – and, if so, prepare terms of reference for that committee.
Choosing individual investments	Take "proper advice" on the suitability of an investment. Take legal advice on trustees' investment powers under the plan rules if there is any uncertainty.	Take legal advice on the features and risks of any investment before entering into it.
While holding an investment	Consider how often, and in what circumstances, to take "proper advice". For trustees of defined contribution plans with default arrangements, the default arrangements and default funds must be reviewed at least every three years. The trustees are also required to provide an annual statement containing confirmation that the default fund provides value for money (this must be in the form of a chair's statement).	Consider: <ul style="list-style-type: none"> • Maintaining a written policy for the assessment of investment managers • Monitoring performance more frequently than annually

What Are the Consequences of Failing to Comply?

Civil Penalties

Failure to comply with a statutory requirement can result in a fine of up to £5,000 for an individual and up to £50,000 for a company.

Criminal Penalties

Additionally, failure to comply with section 40 of the Pensions Act 1995 (restrictions on employer related investments) can result in a trustee who agreed to make the investment being subject to an unlimited fine and/or imprisonment.

Breach of Trust

Failure to comply with trustees' investment duties (whether derived from trust law, the trust deed and rules or legislation) can result in one or more trustees facing a claim for breach of trust. In some cases, a successful breach of trust claim against an individual trustee could result in personal (uncapped) liability.

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