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Pensions Quick Guide

How to … Comply With The Pensions Regulator's Upcoming Single Code of Practice

What Is the Single Code of Practice?

The Pensions Regulator (TPR) has issued a draft new Single Code of Practice (the New Code), which sets out proposed new governance standards for pension schemes. The New Code is both a consolidation of 10 out of 15 existing codes of practice, as well as a significant update and extension of the existing codes. No doubt trustees will be pleased to hear that they have more acronyms to learn!

Currently in draft form, the New Code is the first phase of TPR's efforts to both harmonise and modernise its codes of practice, with the ultimate aim of creating a code of practice appropriate to the needs of pension schemes today and in the future.

The New Code will be applicable to occupational defined benefit and defined contribution schemes, personal pension schemes (to some extent) and public sector schemes (but not all obligations apply to all types of scheme). The New Code takes a module-based approach and currently has 51 topic-based modules grouped into five themes, covering: (1) the governing body, (2) funding and investment, (3) administration, (4) communications and disclosure and (5) reporting to TPR.

What Is the Driver Behind the New Code?

The New Code is a direct result of regulations that came into force in January 2019. The regulations mandated the establishment and operation of an "effective system of governance including internal controls" and the New Code details the processes, procedures and documents pension schemes should have in order to be compliant with this requirement. The New Code can also be seen in the context of TPR's strong belief that there is a connection between good governance and good outcomes for members.

When Does the New Code Come Into Force?

The final version of the New Code is expected to come into force in autumn 2022. However, the New Code contains significant new requirements, which mean that pension schemes should start planning for this now. Even well-run pension schemes with good governance policies and procedures already in place are likely to have a lot to do.

What Are the New Obligations?

Currently, the most significant developments in the New Code are for pension schemes to:

- Establish an "effective system of governance" (ESOG) – This is a step up from the current requirement for pension schemes to have an "adequate" system of governance, which originated from the Pensions Act 2004. A scheme's ESOG will need to be "proportionate to the size, nature and complexity" of the scheme and comply with 17 specific modules identified by TPR.
- Carry out an "Own Risk Assessment" (ORA) – This is not the typical risk assessment process already carried out by pension schemes but an assessment of how well the ESOG is working and the way potential risks are being managed. After the New Code comes into force, schemes will have 12 months to sign off their first ORA, which TPR has warned will be a "substantial process". After that, the ORA should be re-run annually, or where there is a material change in the risks facing the scheme or in its governance processes. The outcome of each successive ORA should factor in to the scheme's management and decision-making process, helping the scheme adapt its governance to the evolving risks it is facing.
- Have a written remuneration policy – This new policy document is to cover anyone who is involved in running the scheme, carries out key functions or whose activities materially impact the scheme's risk profile. The contents of the remuneration policy are to include an explanation of how the levels of remuneration were arrived at and why they are appropriate. The remuneration policy should be reviewed annually or at the least, every three years.
- Draft a policy on the appointment of advisors and service providers – Schemes should have a policy to cover their approach for the selection, appointment, management and replacement of those who advise and help to run the scheme.
- Consider climate change in their governance systems – Trustees should maintain and document processes for identifying and assessing climate change risks and opportunities.
- Build robust cyber security systems – In order to reduce the risk of cybersecurity incidents, schemes should implement policies for ensuring all scheme data is held securely, including assessing the cyber resilience of third-party administrators. There should also be a cyber incident response plan.

A Word on Proportionality

TPR has expressly stated that in many instances, the New Code is not prescriptive and that trustees "need to use their own judgment as to what is a reasonable and proportionate method of ensuring compliance for their scheme". The question of proportionality is, therefore, one where trustees will be expected to exercise their discretion. The draft New Code is currently light on detail on what proportionality in this context will mean. We assume that a light touch approach can be taken by smaller schemes and schemes nearing their end-game. But what about schemes that already have very sophisticated governance arrangements that do not match the TPR model but achieve a similar outcome? In our view, proportionality is going to be a key factor for trustees and we anticipate trustees asking for legal advice to help them make a judgment call.

Some Practical Points

Although some questions will not be answered until we have TPR's response to the consultation, there are preparatory steps that can be taken now.

Do	Don't
Do agree a plan for getting ready for the New Code and, if necessary, set up a sub-committee with the appropriate scope and capacity to manage the different elements	**Don't** assume that an existing policy practice or procedure will meet the standards expected in the New Code
Do carry out a gap analysis of the draft New Code against your existing policies and procedures to see where your scheme expects to be able to meet the requirements and where it will fall short	**Don't** be complacent; time spent preparing for the New Code now will mean you are better prepared for it coming into force
Do create a checklist of policies, practices and procedures required by the New Code with the timescales for implementation, review and sign off	**Don't** fail to document steps taken in readiness for the New Code
Do test existing governance systems to see how robust current procedures are	**Don't** forget to keep all of your policies, processes and procedures under regular review

What Are the Consequences of Failing to Comply?

There are some aspects of the New Code that are statutory requirements, for example, to have an ESOG, a risk register, a Statement of Investment Principles and a dispute resolution procedure. However, the Code is not itself legally binding; it is TPR's expectation of what trustees should do to achieve good governance, whether it is in relation to something that is a legal requirement or otherwise.

While the New Code is not legally binding, the courts and TPR take compliance with any relevant code into consideration when deciding if a statutory requirement has been met. For example, if trustees do not put in place the many policies, processes and procedures that TPR expects them to have as part of their ESOG, then this will be taken into consideration when deciding if they are in breach of the statutory requirement to have an ESOG.

Therefore, ignore the New Code at your peril! Compliance should be seen as much more than a demonstration of "best practice".

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