The Pensions Regulator

Response form 3

The 'Funding and investment' section of the new code of practice

March 2021

Contents

Investment

Investment governance (FAI001)

The term 'investment governance' refers to the policies and procedures that ensure a governing body complies with any obligations it has in relation to investment.

A governing body's powers and responsibilities regarding investment will be scheme specific, and so its governance arrangements must also be relevant and tailored to the scheme (see also **Investment decision-making**).

The scheme managers of local government pension schemes do not have the same obligations in pensions legislation, but it is good practice for them to approach investment governance in the same way.

Obligations of governing bodies of DC and DB schemes

- Have a good working knowledge of investment matters relating to their scheme[IN1]
- Understand the investment powers and duties they have under the scheme trust deed, and rules and legislation[IN2] (see also **Working knowledge of pensions**).
- Appoint a suitably qualified person to advise on investments[IN3] and obtain and consider proper advice before making investment decisions[IN4]
- Produce a statement of investment principles (SIP), which covers their policies relating to the scheme's investments. Learn more in **Statement of investment principles**.
- Produce an annual implementation report as part of their annual report and accounts (see **Implementation report**).

The governing bodies of most DC schemes must produce a SIP for their default arrangement(s) if they have them, which is subject to different requirements. Learn more in **Statement of investment principles**.

IN1 Sections 247 and 248 of the Pensions Act 2004 [Articles 224 and 225 of the Pensions (Northern Ireland) Order 2005]
IN2 Sections 247 and 248 of the Pensions Act 2004 [Articles 224 and 225 of the Pensions (Northern Ireland) Order 2005]
IN3 Section 47 of the Pensions Act 1995 [Article 47 of the Pensions (Northern Ireland) Order 1995]
IN4 Section 36 of the Pensions Act 1995 [Article 36 of the Pensions (Northern Ireland) Order 1995]

Under section 249A of the Pensions Act 2004,[IN5] governing bodies of certain schemes must establish and operate an effective system of governance (see **Scheme governance**) including internal controls (see **Managing risk using internal controls**). However, there are certain exemptions.[IN6] We expect that such governing bodies with investment responsibilities will have the following measures in place:

The governing body should:

- clearly document the objectives, roles, responsibilities and reporting relationships of all parties involved in making investment decisions
- ensure that investment decisions are taken by those with the necessary skills, knowledge, information and resources
- obtain advice and other inputs required to properly govern the scheme's investments (including considering what advice may be needed)
- ensure the governance structure relating to the assessment of investment risks and how investment decisions are made is reviewed regularly and is appropriate for their scheme's circumstances and level of complexity
- delegate investment decisions where appropriate for their scheme's circumstances and level of complexity. This may include delegating to an investment sub-committee or a qualified fund manager.
- have clear terms of reference and appropriate oversight for any bodies with delegated responsibilities
- have written policies covering the use of advisers. These policies should cover when to use advisers for the specific circumstances of the scheme, which should consider the investment knowledge and experience available to the governing body and the relevant legal requirements.
- have sufficient expertise to evaluate and challenge the advice they receive from advisers and service providers
- ensure investment policies take account of potential long-term effects on scheme investments
- assess the performance of scheme investments at least quarterly
- formally consider the performance of investment managers and advisers at least every three years and act upon any issues identified

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IN5 Article 226A of the Pensions (Northern Ireland) Order 2005
IN6 Section 249A(3) of the Pensions Act 2004 [Article 226A(3) of The Pensions (Northern Ireland) Order 2005]

The governing bodies of most DC schemes must produce a SIP for their default arrangement(s) if they have them, which is subject to different requirements. Learn more in **Statement of investment principles**. The governing body of a scheme with a DC element should:

- offer an appropriate choice of investment arrangements for members who do not wish to invest in any default arrangement
- provide access to information to enable members to make an informed choice about where their contributions are invested where more than one investment arrangement is available
- inform members in advance of potential changes to an investment offering
- allow members the opportunity to actively choose to switch to a new DC investment arrangement where their existing arrangement is changed or replaced
- if replacing or modifying an existing investment arrangement, manage the transition costs to maintain value for members

The governing body of a scheme with a DB element should:

- have governance policies that ensure the form and structure of liabilities, the strength of the employer covenant, the risk of sponsor default, life expectancy of members and the need to access cash at particular times are taken into account in investment decision-making
- clearly communicate the policies above to advisers, investment managers and other relevant stakeholders

Glossary

Employer covenant
The ability of the sponsoring employer to financially support a DB pension scheme

Membership profile
The demographics of the scheme membership, including their age and wealth

Sponsor default
The risk that the sponsoring company will default on pensions commitments

Stewardship
The process of taking an active role in oversight of the assets in which the scheme is invested

Stewardship reports
Reports from investment managers explaining what activity they have undertaken in the stewardship of the fund, eg voting at AGMs

Questions for:
Investment governance (FAI001)

INQ1:
Is the title of the module a fair reflection of the content provided within it? If not, what would be a clearer description of this content?

INQ2:
Is it clear from the module what our expectations are, and does this content provide governing bodies with a clear sense of how expectations may be applied to their scheme's own circumstances?

INQ3:
Has the subject matter of the module been covered in sufficient detail and is there any further information or guidance that would assist governing bodies in meeting our expectations?

INQ4:
Are there any expectations that may be considered a disproportionate and/or unreasonable burden for a well-run scheme, or for certain types of scheme or governing body?

INQ5:
Do you have any further comments on the module that have not been covered by the previous questions?

Investment decision-making (FAI003)

Governing bodies of trust-based pension schemes with 100 members or more must invest in a way that ensures security, quality, reasonable liquidity and profitability for the scheme as a whole.[IV1] This also applies to financial managers with delegated investment responsibilities. The law also requires these governing bodies to invest scheme assets predominantly in regulated markets.[IV2, IV3] Unless there are exceptional circumstances, governing bodies should ensure no more than a fifth of scheme investments are held in assets not traded on regulated markets.

Governing bodies of trust-based schemes with fewer than 100 members must ensure their investments are appropriately diversified.[IV4]

Under section 249A of the Pensions Act 2004,[IV5] governing bodies of certain schemes must establish and operate an effective system of governance (see **Scheme governance**) including internal controls (see **Managing risk using internal controls**). However, there are certain exemptions.[IV6] This system will include having processes in place to ensure prudent management of investments.

Governing bodies should:

- have processes in place to make sure investment decisions can be made in an effective and timely manner, and implemented promptly and appropriately
- ensure all the involved parties are clear on where responsibility and accountability sits in relation to the provision of oversight, advice and decision-making
- be able to critically evaluate the main points of the investment information received and understand the basis on which that information has been provided
- ensure costs and charges relating to any advice sought and/or investment transactions that may result represent reasonable value
- consider any likely personal biases and any conflicts of interest the person giving the input may have in the decisions to be made. Learn more in **Conflicts of interest**.

IV1 Regulation 4(3) Occupational Pension Schemes (Investment) Regulations 2005 [Regulation 4(3) Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005]

IV2 Regulation 4(5) Occupational Pension Schemes (Investment) Regulations 2005 [Regulation 4(5) Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005]

IV3 As defined in Regulation 4(11) Occupational Pension Schemes (Investment) Regulations 2005 [Regulation 4(11) Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005]

IV4 Regulation 7(2) of Occupational Pension Schemes (Investment) Regulations 2005 [Regulation7(2) Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005]

IV5 Article 226A of The Pensions (Northern Ireland) Order 2005

IV6 Section 249A(3) of the Pensions Act 2004 [Article 226A(3) of The Pensions (Northern Ireland) Order 2005]

- regularly assess the effectiveness of the governing body's investment decision-making and governance processes
- have clear terms of reference for any sub-committees
- set objectives for their investment holdings, considering the different requirements of the accumulation and decumulation phases
- document objectives and strategies appropriately, and regularly review to assess whether investment performance is in line with objectives and continues to remain suitable for members
- ensure the investment structure and decisions made in relation to investments will deliver the objectives and outcomes in accordance with the principles set out in the SIP (see **Statement of investment principles**).
- document any changes to investments or investment strategy, the reasons they were needed, and the improvements expected
- if using a bespoke investment arrangement to meet specific requirements, document a clear explanation of their strategy and objectives and how the specific requirements will be met
- clearly identify any investments not traded on a regulated market, document why such investments are being used and how they fit in with the agreed investment objectives
- understand the types of protection available, such as indemnity insurance or the Financial Services Compensation Scheme, for their different investments in the event of fraud, wrongdoing or other adverse events
- review the investment managers' fund documentation, get appropriate legal and investment advice and put in place the right level of protection for members, having considered that advice
- consider if and how to communicate the conclusions about the security of assets to members and employers

Glossary

Decumulation
Taking money out of a pension in a legitimate way, for example as a lump sum or by buying an annuity.

Questions for:
Investment decision-making (FAI003)

IVQ1:
Is the title of the module a fair reflection of the content provided within it? If not, what would be a clearer description of this content?

IVQ2:
Is it clear from the module what our expectations are, and does this content provide governing bodies with a clear sense of how expectations may be applied to their scheme's own circumstances?

IVQ3:
Has the subject matter of the module been covered in sufficient detail and is there any further information or guidance that would assist governing bodies in meeting our expectations?

IVQ4:
Are there any expectations that may be considered a disproportionate and/or unreasonable burden for a well-run scheme, or for certain types of scheme or governing body?

IVQ5:
Do you have any further comments on the module that have not been covered by the previous questions?

Implementation report (FAI004)

The law[IM1] requires that trustees of certain trust-based schemes, unless exempt, must produce an annual implementation report as part of their annual report. This must set out the information contained in the list below, and some parts must be made publicly available free of charge on a website.

For all these schemes, the report must include the information set out in the Disclosure regulations.[IM2] The report must cover or include, broadly:

- a statement by the trustees giving details of any investments during the scheme year that were not made in accordance with the statement of investment principles (SIP) and an explanation why
- any action taken or proposed to remedy the deviation from the SIP
- a review of the investments' performance during the scheme year
- an assessment of the type of investments covering their geographical location, liquidity, security and value of the scheme's assets
- how closely, in the opinion of the trustees, they have followed their policy in relation to the exercise of the rights (including voting rights) attaching to the investments
- a description of the voting behaviour by, and on behalf of, the trustees in the preceding year, including the most significant votes cast by trustees
- a statement of any use of the services of a proxy voter during that year
- copies of the trustees' policies in relation to:
  - financially material considerations and non-financial matters that are considered in the trustees' investment activities
  - exercise of the rights attached to investment and undertaking engagement activities relating to the investments (including how and when trustees would monitor and engage with relevant persons about relevant matters)
  - the trustees' arrangements with asset managers[IM3]

IM1 Schedule 3, Part 5, paragraph 30 Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 [Schedule 3, Part 5, paragraph 30 Occupational and Personal Pension Schemes (Disclosure of Information) Regulations (Northern Ireland) 2014]

IM2 Schedule 3, Part 5, paragraph 30 Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 [Schedule 3, Part 5, paragraph 30 Occupational and Personal Pension Schemes (Disclosure of Information) Regulations (Northern Ireland) 2014]

IM3 Regulation 2(3)(d) Occupational Pension Schemes (Investment) Regulations 2005 [Regulation 2(3)(d) Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005]

For relevant DC schemes[IM4] the report must also include:

- how the governing body has followed and acted upon the investment policies set out in their SIP
- details of any review of the SIP during the year
- any subsequent changes made and why
- the date of the last SIP review (where no review was undertaken in the last year)
- a description of the voting behaviour by or on behalf of the trustees, including the most significant votes cast by trustees in the scheme year
- use of a proxy voter during the scheme year

The implementation report should:

- not simply be a 'tick box' report- its purpose is so members can be sure that the scheme is being run as they expect it to be.
- follow the principles for communicating with members as set out in **General principles for member communications**.

IM4 Regulations 1 or 2 of Occupational Pensions Schemes (Scheme Administration) Regulations 1996 [Regulation 1 or 2 of Occupational Pension Schemes (Scheme Administration) Regulations (Northern Ireland) 1997]

Questions for: Implementation report (FAI004)

IMQ1:
Is the title of the module a fair reflection of the content provided within it? If not, what would be a clearer description of this content?

IMQ2:
Is it clear from the module what our expectations are, and does this content provide governing bodies with a clear sense of how expectations may be applied to their scheme's own circumstances?

IMQ3:
Has the subject matter of the module been covered in sufficient detail and is there any further information or guidance that would assist governing bodies in meeting our expectations?

IMQ4:
Are there any expectations that may be considered a disproportionate and/or unreasonable burden for a well-run scheme, or for certain types of scheme or governing body?

IMQ5:
Do you have any further comments on the module that have not been covered by the previous questions?

Investment monitoring (FAI005)

Trustees' fiduciary duties include managing investments with due skill, care and diligence. The law requires trustees who have responsibility for investment decision-making to exercise those powers in accordance with regulation 4 of the Occupational Pension Schemes (Investment) Regulations 2005.[IE1]

Under section 249A of the Pensions Act 2004,[IE2] governing bodies of certain schemes must establish and operate an effective system of governance (see **Scheme governance**) including internal controls (see **Managing risk using internal controls**). However, there are certain exemptions.[IE3] An effective system of governance will include having systems in place to review the performance of their investments.

They may do this by using manager or adviser reports or having meetings with the managers or advisers. If they are relying solely on reports produced by their investment managers, the governing body may wish to seek independent advice to help interpret the reports.[IE4]

The scheme managers of local government pension schemes do not have the same obligations in pensions legislation. However, it is good practice for them to approach investment governance in the same way.

Governing bodies must be confident that investment governance (see **Investment governance**) is carried out in accordance with legal obligations, with the best interests of scheme members and their beneficiaries in mind, and by people with the right expertise (particularly where any of these functions are outsourced).

IE1 Regulation 4 Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005
IE2 Article 226A of The Pensions (Northern Ireland) Order 2005
IE3 Section 249A(3) of the Pensions Act 2004 [Article 226A(3) of The Pensions (Northern Ireland) Order 2005]
IE4 Regulation 2 Occupational Pension Schemes (Investment) Regulations 2005 [Regulation 2 Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005]

Governing bodies should:

- have procedures to review and negotiate the terms of contractual arrangements and fund documents in place with investment managers and advisers as appropriate (see **Managing advisers and service providers**).
- regularly monitor the performance of their scheme's investment advisers (see **Managing advisers and service providers**).
- have procedures in place to monitor their scheme's investments and performance:
  - these procedures should consider investment returns both before and after fees, and against relevant benchmarks
  - these procedures should compare investment performance against the stated investment principles at least quarterly
  - these procedures should consider fees and costs and whether they are justified
  - where applicable, these procedures should consider the governing body's value for members assessment
- consider whether and how to report to interested parties, for example members, participating employers and sponsoring employers

Governing bodies should set expectations for their investment managers to:

- ensure monitoring information is prepared and considered at least quarterly and at shorter intervals as appropriate for the size and complexity of your scheme
- where applicable, include a stress test or scenario test to assess the impact of changing circumstances on scheme assets
- compare net investment returns to any relevant market or industry benchmarks
- monitor the level of investment risk run to deliver the performance and how this compares with the investment manager's risk targets
- consider environmental, social and governance (ESG) factors, including shareholder engagement, and have processes in place to ensure compliance. Learn more in **Stewardship and Climate change**.
- ensure that controls (including those related to the security, liquidity and safe custody of scheme assets) are in place to alert them to potential financial risks related to the investment manager
- regularly assess the effectiveness of their processes, ensuring proper review and monitoring of investments and making improvements as appropriate

Questions for:
Investment monitoring (FAI005)

IEQ1:
Is the title of the module a fair reflection of the content provided within it? If not, what would be a clearer description of this content?

IEQ2:
Is it clear from the module what our expectations are, and does this content provide governing bodies with a clear sense of how expectations may be applied to their scheme's own circumstances?

IEQ3:
Has the subject matter of the module been covered in sufficient detail and is there any further information or guidance that would assist governing bodies in meeting our expectations?

IEQ4:
Are there any expectations that may be considered a disproportionate and/or unreasonable burden for a well-run scheme, or for certain types of scheme or governing body?

IEQ5:
Do you have any further comments on the module that have not been covered by the previous questions?

Stewardship (FAI006)

Environmental, social and governance (ESG) focuses on the wider risk and return considerations for trustees in their decision-making and investment management practices.

Under section 249A of the Pensions Act 2004,[ST1] governing bodies of certain schemes must establish and operate an effective system of governance (see **Scheme governance**) including internal controls (see **Managing risk using internal controls**). However, there are certain exemptions.[ST2] This should include consideration of ESG matters relating to scheme investments. These governing bodies should take an active role in exercising the whole range of rights and responsibilities given to them through their investments.

Governing bodies required to prepare a Statement of investment principles[ST3] must have a policy on the exercise of the rights attaching to their investments.[ST4]

Governing bodies of schemes with 100 or more members[ST5] should incorporate these matters into the scheme's own risk assessment and document them appropriately. Learn more in **Own risk assessment**.

We recommend that governing bodies with investment responsibilities follow the principles set out below, even if they are not legally required to have an effective system of governance.

ST1 Article 226A of The Pensions (Northern Ireland) Order 2005
ST2 Section 249A(3) of the Pensions Act 2004 [Article 226A(3) of The Pensions (Northern Ireland) Order 2005]
ST3 Section 35 of the Pensions Act 1995 [Article 35 of the Pensions (Northern Ireland) Order 1995]
ST4 Regulation 2(3)(c) Occupational Pension Schemes (Investment) Regulations 2005 [Regulation 2(3(c) Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005]
ST5 Regulation 3(8)(h) of the Occupational Pension Schemes (Governance) (Amendment) Regulations 2018 [Regulation 3(8)(h) of the Occupational Pension Schemes (Governance) (Amendment) Regulations (Northern Ireland) 2018]

Governing bodies should:

- identify steps to exercise the rights and responsibilities relating to the investments held, whether directly or indirectly
- ensure governing bodies are familiar with their investment manager's stewardship policies
- enable governing bodies to use investment managers' stewardship policies as selection criteria and seek to influence them as appropriate
- ensure the monitoring and regular review of investment managers' stewardship practices
- make sure governing bodies take into account the potential long-term positive and negative impacts of investment decisions on member outcomes
- seek to follow, where appropriate, the Financial Reporting Council's UK Stewardship Code
- identify and account for the systemic risk of climate change in decisions made about the scheme's investment and funding (see **Climate change**)
- include engagement with investee companies, policymakers and collaborative industry initiatives, whether directly or via investment managers, to mitigate these risks
- consider co-operation with other institutional investors in engaging with investee companies on ESG issues

Questions for: Stewardship (FAI006)

STQ1: Is the title of the module a fair reflection of the content provided within it? If not, what would be a clearer description of this content?

STQ2:
Is it clear from the module what our expectations are, and does this content provide governing bodies with a clear sense of how expectations may be applied to their scheme’s own circumstances?

STQ3:
Has the subject matter of the module been covered in sufficient detail and is there any further information or guidance that would assist governing bodies in meeting our expectations?

STQ4:
Are there any expectations that may be considered a disproportionate and/or unreasonable burden for a well-run scheme, or for certain types of scheme or governing body?

STQ5:
Do you have any further comments on the module that have not been covered by the previous questions?

Climate change (FAI011)

All pension schemes face some degree of material risk from climate change. These risks may include the physical effects of climate change such as:

- rising temperatures
- higher sea levels
- droughts
- floods
- storms

They may also include the impact of changes associated with the transition to a low-carbon economy such as:

- impacts on the strength of any sponsoring employer
- new climate policy
- disruptive technology
- shifting investor sentiment
- deteriorating reputation

Climate change and investments

Under section 249A of the Pensions Act 2004,[CL1] governing bodies of certain schemes must establish and operate an effective system of governance (ESOG) (see **Scheme governance**) including internal controls (see **Managing risk using internal controls**). However, there are certain exemptions.[CL2] An ESOG should ensure that consideration of environmental factors is part of the governing body's investment decision-making (see **Stewardship**). Governing bodies should:

- talk to their advisers and asset managers about how short and long-term climate change risks and opportunities are built into their recommendations
- understand what measures are being taken to reflect climate change risk within investment portfolios

> Governing bodies of certain schemes[CL3] are required to include policies in their **statement of investment principles** on **environmental, social and governance considerations**. This includes climate change.

CL1 Article 226A of the Pensions (Northern Ireland) Order 2005
CL2 Section 249A(3) of the Pensions Act 2004 [Article 226A(3) of The Pensions (Northern Ireland) Order 2005]
CL3 Regulation 2 of the Occupational Pensions Schemes (Investment) Regulations 2005 [Regulation 2 of the Occupational Pensions Schemes (Investment) Regulations (Northern Ireland) 2005]

Governing bodies are not required to align their investment and funding plans with the objectives of the Paris Agreement and other climate change goals, such as the UK's own target of net zero emissions by 2050. However, they may wish to examine how their governance practices and investment decision-making (where applicable) take account of global progress towards those goals.

Managing scheme risks from climate change

Governing bodies that are required to establish and operate adequate internal controls[CL4] for their scheme should, as part of their risk assessment, assess the risks and opportunities associated with climate change. Learn more in **Identifying and assessing risks**.

Under section 249A of the Pensions Act 2004,[CL5] governing bodies of certain schemes[CL6] with 100 members or more[CL7] should have in place a risk-management function as part of their ESOG (see **Scheme governance**). Our expectations for these governing bodies are set out below. Other governing bodies may wish to consider these as best practice.

- Consider the possible short, medium and long-term effects of climate change on the objectives of the scheme and its operations.
- Maintain and document processes for identifying and assessing climate-related risks and opportunities.
- Integrate these processes into their risk management and governance arrangements.
- Ensure the governing body oversees, assesses and manages climate-related risks and opportunities related to the scheme.

CL4 Sections 249A and 249B of the Pensions Act 2004 [Articles 226A and 226B of the Pensions (Northern Ireland) Order 2005]
CL5 Article 226A of the Pensions (Northern Ireland) Order 2005
CL6 (Northern Ireland) Order 2005]
CL7 Section 249A of the Pensions Act 2004 and regulations 3(1)(3)(a), (5), (6) and (9) of the Occupational Pension Schemes (Governance) (Amendment) Regulations 2018 [Article 226A of the Pensions (Northern Ireland) Order 2005 and regulations 3(1)(3)(a), (5), (6) and (9) of the Occupational Pension Schemes (Governance) (Amendment) Regulations (Northern Ireland) 2018]

Glossary

Paris Agreement
The international framework to address climate change

Questions for:
Climate change (FAI011)

CLQ1:
Is the title of the module a fair reflection of the content provided within it? If not, what would be a clearer description of this content?

CLQ2:
Is it clear from the module what our expectations are, and does this content provide governing bodies with a clear sense of how expectations may be applied to their scheme's own circumstances?

CLQ3:
Has the subject matter of the module been covered in sufficient detail and is there any further information or guidance that would assist governing bodies in meeting our expectations?

CLQ4:
Are there any expectations that may be considered a disproportionate and/or unreasonable burden for a well-run scheme, or for certain types of scheme or governing body?

CLQ5:
Do you have any further comments on the module that have not been covered by the previous questions?

Statement of investment principles (FAI008)

Governing bodies of trust-based occupational pension schemes with 100 members or more must prepare a statement of investment principles (SIP) and review it at least every three years.[SA1] They must also review it as soon as possible after any significant change in investment policy.

When preparing the SIP governing bodies must obtain and consider professional advice,[SA2] and consult any sponsoring employer.

The purpose of a SIP is to set out the governing body's investment strategy, including the investment objectives and investment policies they adopt. We have issued guidance of best practice for preparing a SIP for DB schemes (**www.tpr.gov.uk/en/document-library/regulatory-guidance/db-investment/db-investment-governance**).

Governing bodies may have separate SIP documents for each individual arrangement within a scheme, but this is not a requirement. The law requires the governing bodies of relevant schemes[SA3] to make the most recent SIP relating to any default arrangement(s) available to members as part of the chair's annual statement and the scheme's annual report and accounts.

Governing bodies of all schemes required to prepare a statement of investment principles in accordance with section 35 of the Pensions Act 1995 must publish that SIP online, publicly available and free of charge. When publishing a SIP online, governing bodies need to follow our expectations on **General principles for member communications**.

In cases where preparing a SIP is not a legal requirement, in our view it would be good practice for governing bodies to prepare a document that is similar in nature, and to publish it online as if it were a SIP.

SA1 Regulation 2(1) Occupational Pensions Schemes (Investment) Regulations 2005 [Regulation 2(1) Occupational Pensions Schemes (Investment) Regulations (Northern Ireland) 2005]
SA2 Regulation 2(2) Occupational Pensions Schemes (Investment) Regulations 2005 [Regulation 2(2) Occupational Pensions Schemes (Investment) Regulations (Northern Ireland) 2005]
SA3 within the meaning of the Occupational Pension Schemes (Scheme Administration) Regulations 1996 [within the meaning of the Occupational Pension Schemes (Scheme Administration) Regulations (Northern Ireland) 1996]

The SIP must contain:

- the governing body's policy for securing compliance with the legislation on choosing investments[SA4]
- the governing body's policies relating to:
  - the investments to be held by the scheme
  - the balance between different investments
  - risks – including how they are to be measured and managed
  - the expected return on investments
  - the realisation of investments
  - financially material considerations[SA5] and how they are taken into account in investment decisions
  - the extent to which non-financial matters are taken into account in investment decisions[SA6]
  - how the governing body exercises rights, including voting rights, attached to investments
  - undertaking engagement activities in respect of investments, including but not limited to the methods set out in legislation[SA7]
  - any arrangement with the asset manager, setting out the matters described in legislation[SA8]

A default SIP[SA9] must contain:

- the aims and objectives of the trustees or managers in respect of the investments in the default arrangement
- the matters set out in the Investment Regulations[SA10]
- an explanation of the intention to ensure that assets of the default strategy are invested in the best interests of the members using it, and their beneficiaries

SA4 Section 36 of the Pensions Act 1995 [Article 36 of the Pensions (Northern Ireland Order 1995]
SA5 Regulation 2(4) Occupational Pensions Schemes (Investment) Regulations2005 [Regulation 2(4) Occupational Pensions Schemes (Investment) Regulations (Northern Ireland) 2005]
SA6 Regulation 2(4) Occupational Pensions Schemes (Investment) Regulations2005 [Regulation 2(4) Occupational Pensions Schemes (Investment) Regulations (Northern Ireland) 2005]
SA7 Regulation 2(3)(c) Occupational Pensions Schemes (Investment) Regulations2005 [Regulation 2(3)(c) Occupational Pensions Schemes (Investment) Regulations (Northern Ireland) 2005]
SA8 Regulation 2(3)(b) Occupational Pensions Schemes (Investment) Regulations2005 [Regulation 2(3)(b) Occupational Pensions Schemes (Investment) Regulations (Northern Ireland) 2005]
SA9 Regulation 2A (1) Occupational Pension Schemes (Investment) Regulations 2005 [Regulation 2A (1) Occupational Pensions Schemes (Investment) Regulations (Northern Ireland) 2005]
SA10 Regulations 2(3)(b), 2(3)(c) and 2(3)(d) Occupational Pensions Schemes (Investment) Regulations2005 [Regulation 2(3)(b), 2(3)(c) and 2(3)(d) Occupational Pensions Schemes (Investment) Regulations (Northern Ireland) 2005]

There are various steps that a governing body needs to go through when preparing their SIP. Under section 249A of the Pensions Act 2004,[SA11] governing bodies of certain schemes must, with certain exemptions,[SA12] establish and operate an effective system of governance (see **Scheme governance**) including internal controls (see **Managing risk using internal controls**). We expect that such governing bodies with investment responsibilities will have the following measures in place. Other schemes may wish to adopt these principles as best practice:

When preparing their SIP, the governing body should:

- ensure that relevant membership data is accurate
- consider the interests of active and deferred members and any members who are in a decumulation phase within the scheme
- consider any information they have obtained about when and how members may wish to take their benefits
- regularly assess the performance of investments and any investment options, including any default arrangement, within the context of the relevant objectives
- consider evaluating performance by referring to recognised and credible industry benchmarks for investment funds with similar risk/reward profiles
- document the evaluation process for each fund and consider the total amount of costs and charges levied on each fund, including transaction costs wherever possible
- consider the scheme's whole investment strategy (not just individual funds) taking into account the characteristics of different segments of members
- review the governance structure relating to how investment risks are assessed and investment decisions made
- consider the benefits of delegating some of the duties and the potential for establishing an investment sub-committee
- assess the financial materiality of environmental, social and governance (ESG) factors and allow for them when developing and implementing the investment strategy (see **Stewardship** and **Climate change**).
- ask their investment manager(s) and investment adviser for help with assessing the financial materiality of ESG factors if they do not have the necessary expertise in-house

SA11 Article 226A of the Pensions (Northern Ireland) Order 2005
SA12 Section 249A(3) of the Pensions Act 2004 [Article 226A(3) of The Pensions (Northern Ireland) Order 2005]

When preparing their SIP, the governing body should: continued...

- take into account the types of investments scheme member prefer
- carefully consider the demographics of members of the scheme
- carefully consider whether potential ESG issues may affect the risk adjusted return members may receive
- take account of risks affecting the long-term financial sustainability of the scheme investments
- where a pooled fund is chosen, understand the ESG approach of the available funds, including in the selection criteria for new funds
- where a pooled fund is chosen, monitor how managers take into account ESG factors in practice
- consider the risks and opportunities of climate change (see **Climate change**)

In addition, when preparing their SIP, trustees of DB schemes should:

- set out overall DB investment objective(s) for the fund, which allow for:
  - the scheme's liabilities
  - the strength of the employer covenant
  - the risk capacity and appetite of the sponsor and trustees

Glossary

Decumulation
Taking money out a pension in a legitimate way. For example, as a lump sum or by buying an annuity.

Pooled funds
The investment manager pooling all the investments to be invested in the stock market and managing them into a single fund

Relevant scheme
Schemes defined by Regulations 1 or 2 of the Occupational Pensions Schemes (Scheme Administration Regulations) 1996

Questions for:
Statement of investment principles (FAI008)

SAQ1:
Is the title of the module a fair reflection of the content provided within it? If not, what would be a clearer description of this content?

SAQ2:
Is it clear from the module what our expectations are, and does this content provide governing bodies with a clear sense of how expectations may be applied to their scheme's own circumstances?

SAQ3:
Has the subject matter of the module been covered in sufficient detail and is there any further information or guidance that would assist governing bodies in meeting our expectations?

SAQ4:
Are there any expectations that may be considered a disproportionate and/or unreasonable burden for a well-run scheme, or for certain types of scheme or governing body?

SAQ5:
Do you have any further comments on the module that have not been covered by the previous questions?

Default arrangements and charge restrictions (FAI010)

> The requirements of the law to which this module relates are very complex. We recommend governing bodies consider appropriate professional advice and all relevant guidance in order to ensure their scheme complies.

Default arrangements

The law sets out how to identify a 'default arrangement' within a DC pension scheme.[DE1] Governing bodies will need to assess whether any of their investment arrangements satisfy one or more of the default arrangement descriptions set out in the legislation. This assessment will need to allow for a default arrangement being formed from a single investment fund or collection of funds.

Charges and cost restrictions

In certain circumstances and for certain schemes, the law restricts charges that may be imposed on members.[DE2] There are legal restrictions on the amount members can be charged in default arrangements used by employers to meet their duties under automatic enrolment legislation.[DE3]

Some types of charge or cost are excluded and do not count against the charge cap, for example transaction costs. The law also places restrictions on the charging structures that can be used in such default arrangements, prohibiting all but two types of charging structure: a single percentage charge calculated by reference to the value of the member's rights under the scheme, or a specified combination charging structure.[DE4]

DE1 Regulation 1(2) Occupational Pension Schemes (Investment) Regulations 2005 [Regulation 1(2) Occupational Pension Schemes (Investment) Regulations (Northern Ireland) 2005]

DE2 Part 2 Occupational Pension Schemes (Charges and Governance) Regulations 2015 [Part 2 Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015]

DE3 Regulation 6 Occupational Pension Schemes (Charges and Governance) Regulations 2015 [Regulation 6 Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015]

DE4 Regulation 5(1) Occupational Pension Schemes (Charges and Governance) Regulations 2015 [Regulation 5(1) Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015]

Costs and charges continued...

It is against the law to charge more to non-contributing members than they would have had to pay had they been contributing members (also known as active member discounts[DE5]). This ban applies to all investment arrangements within a relevant scheme, not just the default arrangement. Additionally, the law bans member borne commission,[DE6] and governing bodies must report to us any service providers who have such a commission arrangement in place. The ban applies to all arrangements within a scheme used by employers to meet their duties under automatic enrolment legislation.[DE7]

Governing bodies should:

- document how they identify whether default arrangements observe the charge controls
- have processes in place to identify and report any activities involving charging members commission[DE8]

DE5 Regulation 11 Occupational Pension Schemes (Charges and Governance) Regulations 2015 [Regulation 11 Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015]

DE6 Regulation 11A(2) Occupational Pension Schemes (Charges and Governance) Regulations 2015 [Regulation 11A(2) Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015]

DE7 Regulation 6 Occupational Pension Schemes (Charges and Governance) Regulations 2015 [Regulation 6 Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015]

DE8 Regulation 11A(2) Occupational Pension Schemes (Charges and Governance) Regulations 2015 [Regulation 11A(2) Occupational Pension Schemes (Charges and Governance) Regulations (Northern Ireland) 2015]

Glossary

Relevant scheme
Schemes defined by Regulation 1(2) of the Occupational Pension Schemes (Charges and Governance) Regulations 2015

Questions for:
Default arrangements and charge restrictions (FAI010)

DEQ1:
Is the title of the module a fair reflection of the content provided within it? If not, what would be a clearer description of this content?

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DEQ5:
Do you have any further comments on the module that have not been covered by the previous questions?

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Response form 3: **The 'Funding and investment' section of the new code of practice**