

# alert

## Trustee knowledge and understanding – draft code of practice published

### 1 INTRODUCTION

Amid the Pensions Act 2004 maelstrom, on 17 March 2005 the Pensions Regulator (TPR) published a draft code of practice for consultation on trustee knowledge and understanding (TKU). The consultation period runs until 10 June 2005.

The TKU requirements under the Pensions Act are set to come into force on 6 April 2006. In summary, all occupational pension scheme trustees must have sufficient TKU of pensions and trusts law to run their schemes properly. Trustees must also be conversant with scheme documents.

But what does this really mean?

### 2 TKU – SOME BASICS

The consultation paper sets out some essentials to enable trustees to step up to the TKU mark. These include trustees having sufficient TKU to enable them to:

- understand their own schemes and how they work;
- appreciate the advice they are given, enter into discussion with their advisers, challenge them if necessary and participate fully in decision making<sup>1</sup>;
- recognise conflicts of interest and be able to deal with them; and
- become familiar with the most important parts of the documentation which sets out the rules governing their schemes.

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<sup>1</sup> The draft code notes that well-run schemes are likely to have documentary evidence of their trustee decision making processes to make it clear how and why trustees arrived at decisions

# alert

Continued

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### **3 THE SCOPE OF TKU**

The scope of TKU required is translated into “high level principles” in the draft code. These largely cover the areas identified by Opra in the TKU scope documents published back in February 2005<sup>2</sup>. The following is a quick reminder (and update) of what this entails:

- **The law relating to trusts** - including “an understanding of the special nature of a pension trust and the duties, obligations and powers of trustees”;
- **The law relating to pensions** - this includes occupational pensions legislation “in outline” and key provisions of “related legislation that affects pension schemes and impacts on the role and activities of trustees”;
- **Investment** - for DB and DC schemes (including AVCs). This encompasses the different types of assets available for investment and their characteristics. Strategic asset allocation for DB schemes forms an additional “high level principle” as does “investment choices” for DC schemes;
- **Funding** - for DB schemes this incorporates the way in which funding is dependent upon the sponsoring employer’s financial circumstances (the strength of the employer covenant) and the value of the scheme’s liabilities. Another “principle” highlights the “way in which contribution levels are dependent upon funding”.

For DC, a key focus is on the risks borne by scheme members.

- **Fund management for DB and DC** - this includes “the principles of fund management and how performance can be measured”.

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<sup>2</sup> See our Sackers Extra Alert: “Trustees – the scope of knowledge and understanding” dated 8 February 2005

# alert

Continued

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### **4 CONVERSANCE WITH SCHEME DOCUMENTS**

As well as the formal scheme documents, the consultation paper identifies a list of other documents with which trustees need to be conversant. Not surprisingly, communications with members feature (such as booklets and announcements), but so do significant insurance policies and significant agreements or contracts. Trustees also need to be “aware of where all original documents are kept and of the arrangements for their custody, safekeeping and access”.

### **5 DEPTH OF TKU**

For individual trustees, the degree of TKU required “is that appropriate for the purposes of enabling the individual properly to exercise his functions as trustee”. For a director of a corporate trustee, it is “that appropriate for the purposes of enabling the individual properly to exercise the function in question”.

The draft code recognises that TKU “will...vary according to the role of [the] trustee and the nature and complexity of the scheme”. But, for example, all trustees “will need some investment knowledge, even if the decision making power on investments is delegated”. (A greater degree of technical knowledge will be required of a trustee taking on a specialist role, such as the chair of the investment committee.)

For technical scheme documents, trustees should know enough “to enable them to ask relevant questions of their advisers”.

### **6 DEMONSTRATING TKU**

In the run-up to April 2006, the code suggests that each trustee should use the guidance about the scope of TKU to carry out a “training needs analysis” to identify gaps in knowledge. The code also recommends an annual review of trustees’ TKU, to ensure trustees keep up to date.



# alert

Continued

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TPR will ask trustees how they have met the TKU requirements in the scheme return (presumably, therefore, annually). The draft code also anticipates the possibility of trustees maintaining training records.

### **7 PERIOD OF GRACE?**

TPR refers to the learning which trustees require as being “measured in days not weeks”. However, draft regulations were published on 16 March 2005 which indicate that all newly appointed trustees from April 2006 will have a six months “period of grace” from the date they are appointed to meet the new TKU requirements. Such a period will seemingly not extend to directors of a corporate trustee, independent trustees or to those trustees holding themselves out as having pensions expertise.

The closing date for comments on the draft regulations is 26 May 2005.

### **8 CONCLUSION**

The consultation paper contains important insights on the future role of trustees in the post-April 2006 TKU world. All trustees should consider obtaining a copy to see how they measure up. But a final word of comfort; TPR is reassuring trustees that TPR’s role is not only to check on trustees’ progress “but also to advise and assist...in every way that it can”.

A copy of the draft code of practice can be found at:

<http://www.thepensionsregulator.gov.uk/pdf/codeTKU.pdf>

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