



Pension Schemes Member Trustees Revisited

In October the new rules requiring one third member-nominated trustees (MNTs) will bite on many schemes that opted-out under the old system. The new requirements began to come into effect in April 2006 but schemes with an opt-out have a period of grace before they need to comply that will last until 31 October 2007 in most cases.

The main differences from the old system are that:

- opting out is no longer allowed, and
- light-touch legislation gives schemes a more or less free hand to find the necessary one third MNTs in their own way.

It is trustees, not employers, who must put the new requirements into effect.

When we talk about what the legislation requires trustees to do, we say they "must" do it. To refer to things that the Pensions Regulator's (TPR) non-binding code of practice encourages them to do, we say they "should" do it.

In addition to the code, TPR has issued guidance that outlines what schemes need to do in response to the legislation. As we explain under *Timetable*, this varies according to the approach a scheme took to MNTs under the old system.

For the most part, what we say about MNTs also goes (with necessary adjustments) for member-nominated directors (MNDs) of a company that acts as a trustee.

DIY MNTs

The legislation does not make detailed rules about how schemes must find MNTs. Rather, it sets a few minimum requirements and then leaves it up to trustees to work out their own approach.

Likewise, TPR's code of practice does not prescribe how trustees are to put the legislation into practice. Its approach is to emphasise that they should create a system that is based in all respects on principles of:

- proportionality – this means adopting procedures that are appropriate to the scheme in nature and cost. TPR's example

is to find suitable ways to communicate with members according to how numerous and scattered they are;

- fairness – but, TPR says, fair treatment for all members does not necessarily mean the same treatment; and
- transparency – TPR gives the example of reporting to everyone involved on the outcome of a nomination and selection process.

Having designed a system for finding MNTs, the trustees must put it into effect whenever there is a vacancy.

MNTs OR MNDs?

If the trustees of a scheme are all individuals, the MNT requirements apply. If the only trustee is a company, the MND requirements apply.

If a scheme has a corporate trustee as well as individual trustees, the MNT requirements apply, not those for MNDs.

Here, the corporate trustee counts as one trustee alongside the others.

Modified MND requirements apply where a company is trustee of two or more schemes.

MAKING ARRANGEMENTS

With a few exceptions (*see the box*), the trustees of every occupational pension scheme must make "arrangements" for finding MNTs. Making arrangements means designing and building workable procedures that will create a trustee board with one third MNTs.

The requirement for one third means, for example, that a trustee

board of seven needs three MNTs.

If the employer agrees, a scheme can have more than one third MNTs. If, unusually, the rules of a scheme require more than one third MNTs, that higher proportion applies instead.

Main exemptions from MNTs

- Scheme with only one member
- Scheme where every member is a trustee, and every trustee a member
- Scheme with an insolvent employer or in PPF assessment
- Scheme where all the trustees are independent of the employer and the members (e.g. a sole independent trustee)
- Scheme that is not registered for tax purposes
- Stakeholder scheme
- Small scheme with fewer than 12 members who are all trustees, and either all decisions have to be unanimous or there is an independent trustee
- Wholly insured scheme with fewer than 12 members
- Some paid up, wholly insured schemes
- Some centralised schemes for unrelated employers
- Wholly insured scheme with a sole trustee connected to the insurer (exemption from MNDs)
- Executive scheme where the employer is sole trustee, the members are current or former directors, and the members include at least a third of current directors (exemption from MNDs)

Trustees should keep a record of any exemption for which their scheme qualifies, and should keep under review whether it continues to qualify for it. If a scheme ceases to qualify for an exemption, its trustees must set to work to comply with the MNT requirements.

The arrangements must provide for MNTs:

- to be **nominated** as candidates through a process that involves, as a minimum, all active members and pensioners, or organisations that represent them adequately, and

- to be **selected** by some or all of the members.

They must also comply with some **general requirements**. We look at each of these areas.

Nomination

Trustees must consider who to involve in nomination.

Who to include in the nomination process

When they are considering who to include in the nomination process – e.g. whether to rely on representative organisations or whether to include deferreds – trustees should have regard to the principles of proportionality, fairness and transparency. On grounds of transparency they should tell members why they have come to a particular decision about who to involve in the process.

When thinking about whether to involve representative organisations, trustees should consider:

- whether the organisation has representation as one of its purposes,
- what group it represents and what proportion of that group it covers,
- whether the organisation restricts membership,

- whether it is independent of the employer, and
- whether to involve individual members in the nomination process as well, or just representative organisations.

Trustees should not normally rely on a single organisation to represent actives and pensioners because of the different interests those groups have.

If the trustees are considering using constituencies (defined e.g. by location, class of member or section of the scheme) to provide nominations, they should guard against a particular constituency having disproportionate influence. This could be the case if, say, a small constituency had the right to nominate more MNTs than a much larger one.

There are points of detail to be aware of too. Survivors who are receiving pension following the death of a member do not count as pensioners for the purpose of nominating MNTs. If a scheme only has deferred members, the trustees can decide that some or all of them are eligible to make nominations. Their decision should be guided by proportionality, fairness and transparency. (This flexibility allows trustees to be practical and select, say, only

those deferreds for whom they have up-to-date contact details.)

The arrangements should say that the trustees will only accept a nomination if the nominee agrees.

If it wants to (as it normally will), the employer has the right to reserve a veto on the nomination of non-members.

Selection

The trustees have a free hand to decide who will select MNTs from among the nominees. But some scheme members at least must be involved. So, for example, representative organisations can play a part, but only a part. And if the trustees decide to use a panel to make the selection, it must include some members.

Subject to the principles of proportionality, fairness and transparency, trustees can use a single method of selection, or a range of methods in combination according to the circumstances. The code of practice suggests as possible methods – ballots, panels, representative organisations, trades unions, and selection by the trustees already in office.

General requirements for arrangements

The arrangements must say that removing an MNT as a trustee requires the agreement of all the other trustees. But if, exceptionally, the scheme rules allow the members to remove a trustee, the scheme rules take precedence and there is no need for the agreement of the other trustees.

The arrangements must not discriminate against MNTs by excluding them from carrying out any of the trustees' functions simply on the grounds that they are MNTs.

TPR says trustees should consult the employer on issues such as these when designing their arrangements:

- eligibility criteria, including allowing non-members to be eligible if that is what the trustees would like. Any criteria

The arrangements can provide that if there are fewer nominations than vacancies, the nominees are selected automatically. When considering what arrangements to make here, trustees should think about proportionality – would running a selection process be proportionate bearing in mind the size of the scheme and the cost of the exercise?

The arrangements must provide for the people selected as MNTs to be appointed as trustees. (It is a good idea for scheme rules to contain an explicit requirement that the employer must exercise its power to appoint trustees accordingly.)

should have regard to the principles of fairness and transparency in particular;

- term of office; and
- whether an MNT should remain in office if she ceases to be a member of the scheme.

As a practical matter, although the legislation does not give the employer a formal role in shaping MNT arrangements (let alone a veto), it is a good idea for trustees to try to agree all their proposals with the employer.

Trustees should make it part of their arrangements that they will review them at reasonable intervals.

Reasonable period for reviewing arrangements

It should be part of MNT arrangements that the trustees will review them every three to five years. In addition, there should be provision for review at other times if significant events affect the membership in the interim e.g. a large redundancy exercise.

TIMETABLE

In order to know when they must have their arrangements in place, trustees need to establish when the MNT requirements first

apply to their scheme. They must design their arrangements within a reasonable period of that date.

When the new MNT requirements first apply

On 5 April 2006 the scheme had an opt-out from MNTs under the old system – earliest of:

- the date the members' approval of the opt-out ends, being:
 - if the approval process began after 5 October 2002, 4 years after approval
 - otherwise, 10 years after approval
- the date the employer tells the trustees that it wants to end the opt-out
- 6 months after the trustees tell the employer that they want to end the opt-out (trustees can only do this in certain

circumstances), and

- 31 October 2007. This will be the operative date for many schemes

On 5 April 2006 the scheme had plain MNTs under the old system – 6 April 2006. But having made its arrangements within a reasonable period of 6 April 2006, the scheme would not generally need to implement them to fill a vacancy until some time later. See over the page;

New scheme set up on or after 6 April 2006 – date scheme established

Once arrangements are in place, the trustees must take steps to implement them within a reasonable time of a vacancy arising. Also, if a vacancy remains unfilled after the trustees have carried

out a nomination and selection process, they must re-run the procedure at reasonable intervals until there is an appointment.

Reasonable periods for nomination and selection

Nomination and selection should take place within six months of a vacancy for an MNT arising, but need not necessarily be complete within that period.

Having set that general benchmark, TPR continues that what is reasonable will depend finally on the size, structure and circumstances of the scheme. For example, what is reasonable for a large multi-employer, multi-site scheme where deferreds are participating in

nomination and selection might well be unreasonable for a single-site scheme with twenty actives as its entire membership.

If a vacancy remains unfilled because there were insufficient nominations, the trustees should re-run the process within three years. But if there is a significant change in the membership meanwhile – say because of a bulk transfer – they should consider doing so sooner.

‡Someone appointed as a plain MNT under the old system continues to count as an MNT under the new one until they cease to be a trustee (by their term expiring, resigning etc). This transitional measure

delays the time when a scheme that had plain MNTs needs to implement its new arrangements to fill a vacancy. Note that the measure does not apply to someone appointed under an opt-out.

COMMUNICATION

At the nomination stage trustees should communicate the key details to the members and any organisations involved, including at least:

- the number of MNTs the scheme must have,
- the number of MNT vacancies,
- a short explanation of the role of a trustee and any available training,
- any eligibility criteria,
- what will happen if the number of nominations is smaller than or equal to the number of vacancies,
- details of the selection process that will operate if there are more nominations than vacancies, or if the trustees decide to hold one anyway,
- how to nominate someone for selection as an MNT,
- any time limits that apply, and
- a contact for queries.

At the selection stage the trustees should tell to the members and any organisations involved at least:

- who the nominees are,
- the method of selection,
- what those making the selection need to do.

The trustees should communicate the outcomes of the nomination and selection processes, and the method of selection, to all of the members and organisations involved in both processes.

The timetable for communication should leave people enough time to consider and respond to what they are told.

The trustees should consider how best to communicate with members and representative organisations. The appropriate method is likely to vary according to the size of the scheme and whether the intended recipients are actives or deferreds, for example.

RECORD KEEPING

Trustees should keep records of how they have complied with the legislation and the code. Good examples are evidence of:

- issues they considered in designing their arrangements,
- what they consulted the employer about at the design stage and what the employer's views were,

- their reasons for designing their arrangements the way they have,
- how they conducted each nomination and selection process, and what the outcome was.

Proper record keeping is likely to lead to some substantial files.

SANCTIONS

It is trustees who have the obligation to comply with the MNT legislation. If they fail to, TPR has a range of sanctions, including issuing an improvement notice, and prohibiting someone from being a trustee. It can also impose a civil fine.

The code of practice is not legally binding. But a court or a

tribunal that is dealing with an issue that the code covers must take into account whether the trustees have complied with it. Also, TPR could frame an improvement notice to the trustees around the standards that the code sets. In these ways, the code can have an indirect legal effect.

ACTION FOR TRUSTEES

- Read TPR's code of practice and guidance (and minute the fact that you have).
- Work out when the new requirements apply to your scheme and then set your timetable for making arrangements and implementing them.
- Make a checklist of what needs to be in your new arrangements.
- Consider whether you want to or can retain any of your current arrangements.
- Test all your ideas about MNT arrangements against the principles of proportionality, fairness and transparency.
- Keep full records of the steps you take in designing and implementing your arrangements.

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