

Understanding the Single Code of Practice:

# *Guide to the ESOG*

February 2022

This guide provides a high-level summary of the new Effective System of Governance (“ESOG”) requirements being introduced by The Pensions Regulator’s (“TPR”) single Code of Practice (the “Code”). We encourage trustees to read this guide alongside the draft Code which is available on **TPR’s website**.

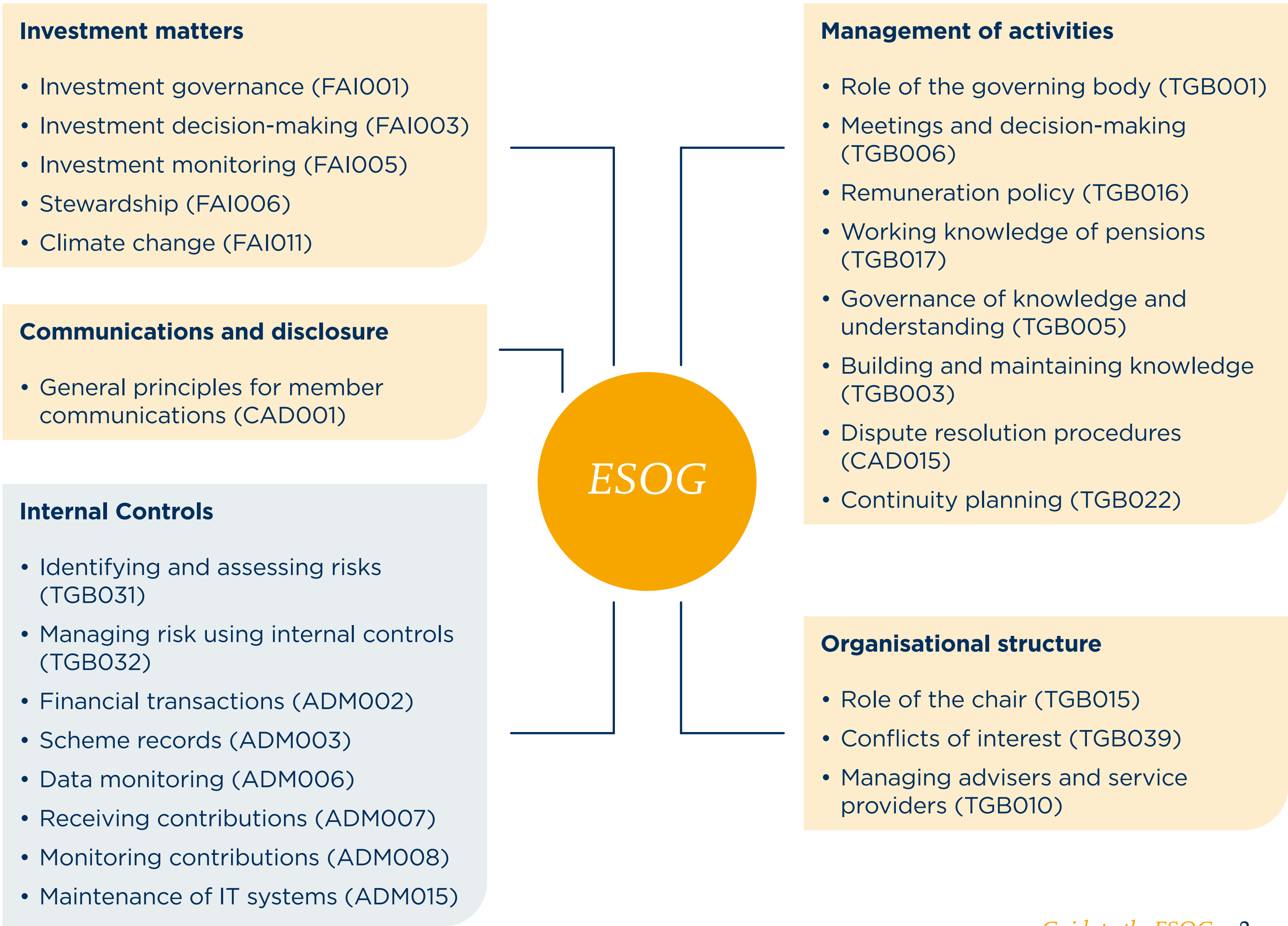


# Introduction to the ESOG

Schemes with more than 100 members are required to establish and operate an effective system of governance otherwise known as an ESOG. An ESOG is essentially a collection of processes and policies that a scheme should have in place in order to operate effectively and efficiently.

An ESOG framework will include processes and procedures across the 17 modules in the Code relating to management of activities, organisational structure, investment matters & communications and disclosure. It also includes eight modules relating to internal controls.

Once an ESOG is established, each element should be reviewed at least every three years (or sooner if there is significant change to the scheme’s governance or key risks) to see whether it is functioning as planned. Trustees should have policies in place for ESOG reviews, and these policies should also be reviewed every three years.



## Why an ESOG matters

Having a defined and robust governance framework for your scheme is fundamental to making good decisions and achieving better outcomes for your members. It puts your scheme ahead of the pack when it comes to dealing with the unexpected and taking advantage of market opportunities. We encourage governing bodies to embrace the new requirements proportionately and in a way that enhances how they operate.

Many pension schemes will already have robust governance frameworks in place and meet most of the requirements for an effective system of governance. However, it is likely that some changes to schemes' existing policies and processes will be required to meet new requirements.

## The purpose of the Code

TPR's codes of practice are not statements of law, except when set out in legislation. Codes of practice set out TPR's expectations on how it expects schemes to comply with the law in certain areas. The new code distinguishes between legal duties and TPR's expectations. In this guide:

- Legal duties are shown by using the word **'must'**
- The Regulator's expectations use the word **'should'**

## A note on proportionality

Whilst TPR has broadly the same expectations for each type of scheme, the systems and controls put in place by a scheme should be proportionate to its size, scale, nature and complexity and the amount of resources and support available to the trustee to make changes. There is currently no guidance on how proportionality should be assessed and trustees may wish to discuss their approach with their legal advisers. In our view, it may be helpful for trustees to consider the following when addressing the new requirements:

- **Size** - there are some exemptions for schemes with fewer than 100 members
- **Scale** - larger schemes may have more involved governance frameworks and there might be a lighter touch approach for smaller schemes
- **Complexity** - there might be greater complexity where there are lots of employers or benefit categories, or for schemes with complex investment and funding strategies
- **Nature** - different approaches may be taken depending on the status of the scheme (open or closed to accrual) and where a scheme is relative to its derisking journey and some modules will not apply to DC schemes. Circumstances, such as a challenged covenant or funding position, may also require additional governance in order to support timely decision making.

## ESOG Policies and procedures

The rest of this document sets out a high-level summary of each of the modules included in the ESOG and the policies and procedures trustees need to consider and address. This list will be updated as the draft Code develops and once the final Code comes into effect.

# Management of activities

Module references	Summary of requirements	Policies and procedures required
TGB001 Role of the governing body	<ul style="list-style-type: none"><li>Those responsible for appointing members to the governing body need to do so using the principles of proportionality, fairness and transparency, while also considering the mix of skills and experience needed by the governing body.</li><li>Governing bodies <b>should</b> meet TPR’s expectations on how trustees of trust-based schemes should act as set out on page 10 of the draft Code. These include behaviours such as acting honestly and with integrity, meeting legal obligations and acting in the interests of all scheme members and beneficiaries.</li></ul>	<ul style="list-style-type: none"><li>Appointment and induction process for new Trustees</li></ul>
TGB006 Meetings and decision making	<ul style="list-style-type: none"><li>Governing bodies <b>must</b> include certain items in their written meeting records as set out on page 19 of the Code, such as the meeting’s details, attendees and decisions made.</li><li>Governing bodies <b>should</b> also establish processes for planning and running meetings and making robust decisions, as set out on page 20 of the draft Code.</li></ul>	<ul style="list-style-type: none"><li>Terms of reference for any sub-committees</li><li>Meeting minutes</li></ul>
TBG016 Remuneration policy	<ul style="list-style-type: none"><li>As set out on page 22 of the draft Code, governing bodies <b>should</b> establish a proportionate written remuneration policy that applies to all persons or corporate bodies who run the scheme, carry out key functions or whose activities materially impact the scheme’s risk profile and any outsourced service providers. The policy should support the effective management of the scheme and include measures to mitigate against potential conflicts of interest and an explanation of the decision-making process for the levels of remuneration and why these are considered appropriate.</li><li>The policy <b>should</b> be reviewed every three years and be published online for members or otherwise made available to members.</li></ul>	<ul style="list-style-type: none"><li>Remuneration policy</li></ul>



# Management of activities

Module references	Summary of requirements	Policies and procedures required
TGB017 Working knowledge of pensions TGB005 Governance of knowledge and understanding TGB003 Building and maintaining knowledge	<ul style="list-style-type: none"><li>Governing bodies <b>should</b> maintain a list of all items that they should be familiar with, and review this regularly. The items that TPR considers to be key are set out on pages 24 to 27 of the draft Code. The list is not exhaustive and covers areas such as pensions law, scheme specific information, scheme funding and investments, risk management, administration and communications.</li><li>The governing body as a whole <b>should</b> demonstrate they jointly possess the skills, knowledge and experience to run the scheme effectively by meeting the requirements set out on page 29 of the draft Code. This, for example, includes having sufficient skills to question advice.</li><li>Members of a governing body <b>should</b> invest sufficient time in their learning and development in order to ensure their knowledge and understanding is maintained. Members of a governing body should meet the requirements set out on page 30 of the draft Code. This includes, for example, identifying gaps in knowledge and understanding at least annually.</li></ul>	<ul style="list-style-type: none"><li>List of items trustees should be familiar with (as per the guidance given in the Code)</li><li>Training plan for the ongoing maintenance and development of knowledge</li><li>Records of learning activities (training logs)</li><li>Approach to reviewing knowledge and understanding and addressing any gaps</li></ul>
CAD015 Dispute resolution procedures	<ul style="list-style-type: none"><li>Governing bodies <b>must</b> put in place formal procedures and processes to investigate and decide upon pension scheme disputes quickly and effectively.</li><li>In particular, governing bodies <b>must</b> ensure their scheme's procedures allow a reasonable period, which should be at least six months, for people or their representatives to make their applications.</li><li>The full requirements for resolution procedures are set out on pages 134 and 135 of the Code. We would anticipate most up to date IDRPs to meet these requirements.</li></ul>	<ul style="list-style-type: none"><li>Internal Dispute Resolution Procedure</li></ul>
TGB022 Continuity planning	<ul style="list-style-type: none"><li>Governing bodies <b>should</b> develop and implement continuity plans to ensure that the operations of their scheme can be maintained in the event of a disruption to the activities of the scheme. Such events could include disruption to the scheme's general administration, the service provided by advisers and trustee decision making.</li><li>TPR's expectations of governing bodies are set out on page 47 of the draft Code.</li></ul>	<ul style="list-style-type: none"><li>Scheme continuity plan covering all trustee business</li></ul>

# Organisational structure

Module references	Summary of requirements	Policies and procedures required
<b>TGB015</b> <b>Role of the Chair</b>	<ul style="list-style-type: none"><li>Governing bodies of occupational pension schemes need to have someone who fulfils the role of chair as a matter of best practice. The role of the chair is set out on page 18 of the draft Code, and includes skills such as communication, debating, challenging, negotiating and the ability to gather and understand diverse views.</li><li>TPR expects the appointment of a chair to be set out in a robust and documented process.</li></ul>	<ul style="list-style-type: none"><li>Policy on the process for appointing a chair</li></ul>
<b>TGB039</b> <b>Conflicts of interest</b>	<ul style="list-style-type: none"><li>Governing bodies <b>should</b> meet TPR’s expectations for identifying and recording conflicts of interest as set out on page 50 of the Code. In particular, governing bodies should be mindful of any conflicts of interest arising from advisers and service providers both at the time of their appointment and as any conflicts arise.</li></ul>	<ul style="list-style-type: none"><li>Conflicts of interest policies for trustees and advisers</li><li>Conflicts of interest register</li></ul>
<b>TGB010</b> <b>Managing advisers and service providers</b>	<ul style="list-style-type: none"><li>Governing bodies <b>should</b> follow TPR’s expectations in relation to the selection, appointment, management and replacement of professional advisers and service providers, as set out on pages 33 to 35 of the draft Code. We anticipate that whilst most schemes will have tested frameworks in place, many will need to consider how best to document their approach as part of the ESOG.</li></ul>	<ul style="list-style-type: none"><li>Policy for appointing and managing advisers and providers, including addressing poor service</li><li>Delegation schedule(s)</li><li>Performance indicators (KPIs, SLAs, objectives)</li><li>Records of assessment of advisers and progress</li><li>Procedure for replacing or changing advisers or providers</li></ul>

# Investment matters

Module references	Summary of requirements	Policies and procedures required
<b>FAI001</b> Investment governance	<ul style="list-style-type: none"><li>• 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. The obligations of governing bodies of DC and DB schemes is set out on page 62 of the draft Code and includes, for example, having a good working knowledge of investment matters and investment powers and duties in the scheme and producing a SIP and annual implementation report.</li><li>• Governing bodies with investment responsibilities <b>should</b> also have certain measures in place, for example around clarity of roles and responsibilities and investment decision making, as set out on pages 63 and 64 of the code.</li></ul>	<ul style="list-style-type: none"><li>• Statement of Investment Principles</li><li>• Documentation of the objectives, roles, responsibilities and reporting relationships of all parties involved in making investment decisions</li><li>• Terms of reference for any investment sub-committee</li><li>• Policies on the use of investment advisers</li><li>• Procedure for considering the performance of investment managers and advisers</li></ul>
<b>FAI003</b> Investment decision making	<ul style="list-style-type: none"><li>• Governing bodies <b>must</b> invest in a way that ensures security, quality, reasonable liquidity and profitability for the scheme as a whole.</li><li>• Governing bodies <b>should</b> have processes in place to ensure the prudent management of investments as set out on pages 65 and 66 of the draft Code. This includes, for example, processes around investment decision making, clarity around roles, responsibility and accountability and the management of conflicts of interest.</li></ul>	<ul style="list-style-type: none"><li>• Process to ensure investment decisions are made in an effective and timely manner</li><li>• Regularly assess the effectiveness of decision making</li><li>• Document objectives, strategies and changes to investments or investment strategy</li></ul>
<b>FAI005</b> Investment monitoring	<ul style="list-style-type: none"><li>• Governing bodies <b>should</b> have systems in place to review the performance of their investments as set out on page 70 of the draft code. This includes, for example, procedures to review and negotiate the terms of contractual arrangements, regularly monitoring the performance of the scheme’s investment advisers and setting expectations for their investment managers in relation to investment performance, returns and risk.</li></ul>	<ul style="list-style-type: none"><li>• Procedure to review and negotiate the terms of contractual arrangements and fund documents with managers and advisers</li><li>• Procedures to monitor investments and performance</li><li>• Policy on whether and how to report on investment performance to interested parties (members, employers)</li></ul>

# Investment matters

Module references	Summary of requirements	Policies and procedures required
FAI006 Stewardship	<ul style="list-style-type: none"><li>Governing bodies <b>should</b> consider ESG matters relating to scheme investments and take an active role in exercising the whole range of rights and responsibilities given to them through their investments.</li><li>Governing bodies required to prepare a SIP <b>must</b> have a policy on the exercise of the rights attaching their investments.</li><li>TPR recommends that governing bodies follow the principles set out on page 72 of the draft Code.</li></ul>	<ul style="list-style-type: none"><li>Process for exercising the rights and responsibilities relating to the investment held</li><li>Policy on monitoring and regular review of investment managers' stewardship practices</li><li>Identify and account for the systemic risk of climate change in decisions made about investment and funding and engage with stakeholders to mitigate these risks</li></ul>
FAI011 Climate change	<ul style="list-style-type: none"><li>Governing bodies <b>should</b> ensure that consideration of environmental factors is part of its investment decision-making. TPR expects governing bodies to:<ul style="list-style-type: none"><li>understand from their advisers and asset managers how short and long-term climate change risks and opportunities are built into their recommendations; and</li><li>understand what measures are being taken to reflect climate change risk within investment portfolios.</li></ul></li><li>Governing bodies <b>should</b>, as part of their internal controls risk assessment, assess the risks and opportunities associated with climate change.</li></ul>	<ul style="list-style-type: none"><li>Maintain and document processes for identifying and assessing climate related risks and opportunities</li><li>Document the management of climate related risks in the risk register</li></ul>



# Communication and disclosure

Module references	Summary of requirements	Policies and procedures required
CAD001 General principles for member communications	<ul style="list-style-type: none"><li>When preparing communications to members, the governing body <b>should</b> meet the general principles set out by TPR on page 114 of the draft Code. These principles include ensuring communications are accurate, clear, concise, relevant and in plain English and considering the use of technology and producing accessible content such as Braille or large font.</li></ul>	<ul style="list-style-type: none"><li>Meet TPR's general principles when communicating with members</li></ul>

# Internal Controls

Module references	Summary of requirements	Policies and procedures required
TGB031 Identifying and assessing risks TGB032 Managing risk using internal controls ADM002 Financial transactions ADM003 Scheme records ADM006 Data monitoring ADM007 Receiving contributions ADM008 Monitoring contributions ADM015 Maintenance of IT systems	<ul style="list-style-type: none"><li>Governing bodies <b>must</b> establish and operate internal controls which are adequate for the purpose of securing that the scheme is administered and managed in accordance with the scheme rules and with the requirements of the law.</li><li>Governing bodies <b>should</b> ensure that their internal controls are proportionately documented and reviewed at least annually or sooner if substantial changes take place.</li><li>TPR expects that the process for monitoring, recording and mitigating risk is closely integrated with the operation of internal controls.</li><li>Governing bodies <b>should</b> also have in place the systems, arrangements and procedures in the 8 modules listed in first column of this table.</li></ul>	<ul style="list-style-type: none"><li>Risk register</li><li>Procedures to ensure financial transactions are processed promptly and accurately</li><li>Record keeping processes</li><li>Data monitoring processes, including data reviews and data protection</li><li>Payment schedule (DC schemes) or schedule of contribution (DB Schemes)</li><li>Procedure for monitoring contributions (if any)</li><li>An IT Policy covering maintaining, upgrading, and replacing hardware and software</li><li>Performance indicators (KPIs, SLAs, objectives) – see Module TGB010</li><li>Procedures in place to reconcile employer data and scheme data, if appropriate.</li><li>Procedures in place to address when an sponsor fails to meet their legal duties to the scheme, in relation to scheme data and record keeping</li><li>Cyber security procedures</li></ul>



# How we can help

LCP’s Pensions Management Consulting team of governance consultants and scheme managers, along with other specialists at LCP, are well placed to help you meet the new requirements in the single Code of Practice.

## Our services

- Governance Healthcheck**

  - Review your existing governance framework against the effective system of governance requirements of the Code of Practice.
  - Identify any governance gaps for the trustees or in-house team to address.
- Governance Healthcheck Plus**

  - As per the Governance Healthcheck plus, drafting and implementing any new policies and procedures that have been identified to meet ESOG requirements.
- LCP’s own risk assessment (ORA) service**

  - Specialist own risk assessment in line with TPR guidelines.
  - Identification of any areas that require further focus.
  - Presentation of findings to the board and assistance with agreeing next steps.

We take a tailored approach to consulting and if you prefer, we can deliver a bespoke service to meet your needs.

## How our approach benefits you

- ✓ Specialist support provides comfort of good governance.
- ✓ Professional support introduces independence.
- ✓ Gives the trustees a clear plan of action of what areas need more focus.
- ✓ Trustees benefit from our deep understanding of governance best practice and our experience of working with many different schemes.
- ✓ Relieves the extra governance burden that might otherwise fall to the in-house pensions team or the trustees themselves.
- ✓ Allows trustees to focus on high level and strategic issues, leaving the detail to us.
- ✓ Our support is tailored to meet your needs and the approach taken will be proportionate to your scheme’s size, nature, scale and complexity.



## Contact us

If you'd like further information, please contact your regular LCP adviser or one of our specialists for more support.



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*At LCP, our experts provide clear, concise advice focused on your needs. We use innovative technology to give you real time insight & control. Our experts work in pensions, investment, insurance, energy, financial wellbeing and business analytics.*

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