

# Report of The Pensions Board to The Minister for Social and Family Affairs on Trusteeship



An Bord Pinsean -  
**The Pensions Board**

Authority for Pensions



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## TABLE OF CONTENTS

<b>1.</b>	<b>Origin of Review .....</b>	<b>1</b>
<b>2.</b>	<b>Terms of Reference .....</b>	<b>2</b>
<b>3.</b>	<b>Recent relevant developments .....</b>	<b>3</b>
3.1	Recent developments .....	3
3.2	The changing pensions environment .....	3
3.3	Irish legislative changes .....	3
3.4	Law Reform Commission Trust Law Proposals .....	4
3.5	Recent UK developments .....	5
3.6	Irish Research .....	5
<b>4.</b>	<b>Specific issues .....</b>	<b>8</b>
<b>5.</b>	<b>External Regulation .....</b>	<b>9</b>
5.1	The trust model and pension scheme governance.....	9
5.2	Professional Master Trust Arrangements.....	10
5.3	Possible extension of legal framework (to include alternatives to trusts).....	12
5.4	Regulation/Registration of Administrators .....	12
5.5	Relationship between trustees and service providers (other than administrators)....	15
5.6	Position of Employer as Sole Trustee .....	16
5.7	Possible role of an “independent trustee” of schemes .....	17
5.8	Appointment of trustees where none exist .....	18
<b>6.</b>	<b>Trustee Ability .....</b>	<b>20</b>
6.1	Possible extension of IORPs trustee requirements .....	20
6.2	Trustee Training .....	21
6.3	Trustee Remuneration .....	23
<b>7.</b>	<b>Internal Scheme Governance .....</b>	<b>25</b>
7.1	Relationship between trustees of the same scheme .....	25
7.2	Relationship with employer .....	26
7.3	Member Trustee Regulations .....	27
<b>8.</b>	<b>Summary and Conclusions .....</b>	<b>29</b>
<b>9.</b>	<b>Table of actions, including location of responsibility and timeline .....</b>	<b>30</b>
	<b>References .....</b>	<b>32</b>
	<b>Appendix A – Pensions Board response to Law Reform Commission’s proposals on trust law .....</b>	<b>33</b>
	<b>Appendix B – Existing supports to trustees (extract from Pensions Board’s 2005 Annual Report) .....</b>	<b>37</b>
	<b>Appendix C – Membership of Trusteeship Sub-Committee and the Pensions Board .....</b>	<b>38</b>

# **1. Origin of Review**

- 1.1** A review of trusteeship was part of the Pensions Board's programme of policy work for 2001-2005. A list of major issues to be covered in a review was considered by the Board's Policy Committee.
- 1.2** In the light of the Minister's request, in February 2005, for the Board to bring forward by one year the 2006 statutory review of coverage and related matters, and the Board's response thereto, the trusteeship project was deferred until the coverage review was completed.
- 1.3** Subject to some amendments, and having regard to the letters of the Minister to the Chairman of 13 December 2004 and 3 February 2005, an outline review of trusteeship was agreed by the Board's Policy Committee in November 2005. This report generally follows the structure of that agreed outline, as approved by the Trusteeship Review Sub-Committee of the Board, established in April 2006. The membership of this Committee is included at Appendix C.
- 1.4** This report represents a review of trusteeship, as requested by the Minister, building upon recent work undertaken in this area, discussions at the review Board, consultation with industry bodies, and an examination of recent relevant developments. It also draws on recent independent academic research, including work undertaken by Ciaran Lawler of the Department of Social and Family Affairs under the supervision of the Institute of Public Administration.
- 1.5** The report prepared by the trusteeship Sub-Committee has been considered at a special meeting of Board members and at the September and October 2006 meetings of the Pensions Board. The report was approved by the Board at the October meeting and subsequently submitted to the Minister for Social and Family Affairs for his consideration and approval.

## **2. Terms of Reference**

**2.1** Taking account of the outline agreed by the Policy Committee, the following broad terms of reference set out the main objectives of this review:

- (i) Evaluate the trust model of pension scheme governance;
- (ii) Identify potential regulatory and governance improvements that can be made to enable the trust model to perform more effectively;
- (iii) Examine the supports in place for trustees.

**2.2** Any outcomes emanating from this report should be designed to facilitate competent performance of trustees' duties, and increased governance standards, while minimising any additional compliance burden on trustees, schemes and employers.

### **3. Recent relevant developments**

#### **3.1 *Recent developments***

- 3.1.1 This section provides a brief overview of significant developments that inform this report's content. A brief examination of the changing pensions environment and how this affects trustees is followed by an overview of relevant legislative developments, the proposals put forward by the Law Reform Commission in its consultation report on trust law, the outcome of recent research on trusteeship, and recent developments in the United Kingdom.

#### **3.2 *The changing pensions environment***

- 3.2.1 Supplementary pension provision is facing the challenges of low coverage rates, lower investment returns, increases in liabilities, funding difficulties for defined benefit schemes, and the further risk to defined benefit provision posed by the introduction of new accounting standards. The adequacy of contribution rates to defined contribution schemes, allied to the problems of low investment returns and increased longevity, has raised questions about the adequacy of future pensions. In addition, increasing pressures on trustees have encouraged fresh examination of the trustee role and how (or whether) trustees can continue to contribute positively to pension scheme governance.
- 3.2.2 Recent international debate has focused on the area of pension scheme governance and the contribution that regulatory and governance structures make to the effective performance of national pension systems. In Ireland and the UK, attention has focused on trustees and their ability to manage pension schemes, particularly those which are becoming increasingly large financial entities. Some commentators have questioned whether non-professional trustees can continue to contribute positively to pension scheme governance in an era of increasing investment complexity and uncertainty, the challenge of funding requirements, and continuous regulatory change.

#### **3.3 *Irish legislative changes***

- 3.3.1 New requirements flowing from transposition of the EU Pensions Directive 2003/41/EC of the European Parliament and of the Council of 3 June 2003 on the activities and supervision of institutions for occupational retirement provision (IORPs), as well as cumulative amendments to pensions law generally, have changed the regulatory environment and placed more demands on trustees. Successive changes to the Pensions Act, 1990, as amended, ("the Act"), for example, while necessary, are continuously placing new requirements on trustees or changing responsibilities that already exist.
- 3.3.2 The IORPs Directive was transposed via the Social Welfare and Pensions Act, 2005. The Directive allows for pension schemes to operate across EU Member States and a new Section XII, together with underlying Regulations, was inserted into the Act to allow for this in an Irish context. In addition, the Directive put a framework in place for the operation of pensions schemes in the EU generally,

including a duty to produce a statement of investment policy principles, new investment rules, and requirements on the qualification and experience of those running the “institution for occupational retirement provision”. In an Irish context, for example, the Occupational Pension Schemes (Trustee) Regulations, 2006 (S.I. No. 293 of 2006) require that trustees who do not enter into an arrangement with an investment manager to provide an investment service in respect of the investment of the resources of the scheme, must satisfy the Board that they possess qualifications and experience appropriate and relevant to investment of the resources of the scheme or have entered into arrangements with advisers possessing the necessary qualifications and experience.

- 3.3.3 *The Social Welfare (Miscellaneous Provisions) Act, 2004*, introduced changes to the Act, specifying that trustees apply the principle of equal pension treatment in their pension schemes. While the Act originally only applied the principle of equal treatment on gender grounds, it was extended to cover the grounds of marital status, family status, sexual orientation, religion, age, disability, race, and membership of the Traveller community. The principle of equal pension treatment specifies that a rule of a scheme cannot discriminate on any of these grounds.
- 3.3.4 The Family Law Act, 1995 and The Family Law (Divorce) Act, 1996 (together known as “the Family Law Acts”), require the court to take into account the value of pension benefits in determining any financial settlement following the granting of a decree of judicial separation or divorce. The Family Law Acts also provide that the court may on the application of either of the spouses concerned or by a person on behalf of a dependent member of the family, make an order in relation to a retirement benefit, under a pension scheme of which one of the spouses concerned is a member, providing for the payment of a benefit consisting of the whole or part of the retirement benefits that is payable under the pension scheme and has accrued at the time of making the decree, to the other spouse or to the dependent family member\*. The Occupational Pension Schemes (Disclosure of Information) Regulations, 2006, (S.I. 301 of 2006) require specific information to be furnished to the spouse of the member concerning the benefits both before and after the Pension Adjustment Order is made. The pension provisions of the Family Law Acts are among the more detailed statutory requirements with which trustees have to comply.
- 3.3.5 Other relatively recent regulatory changes of which trustees need to be aware, and comply with, include monitoring contribution and benefit levels where Personal Retirement Savings Accounts (PRSAs) are used to make additional voluntary contributions, the whistleblowing requirements introduced via the Pensions (Amendment) Act, 1996, and changes to disclosure requirements and the statutory Funding Standard.

### **3.4 Law Reform Commission Trust Law Proposals**

- 3.4.1 The Law Reform Commission has carried out two exercises on trust law. The first of these – The Variation of Trusts Report (2000) – recommends legislation to give the court power to approve variation of trusts on behalf of certain beneficiaries (including persons who are minors, or not yet born, or who cannot be located, or who have a merely contingent interest in the trust). The proposed legislation does not give the court a general power to vary trusts but merely a power to approve

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\* The court also holds the power to make an order in respect of death in service benefits.

variations on behalf of certain beneficiaries where consent is required but cannot, in practice, be obtained.

- 3.4.2 More recently, the Law Reform Commission engaged in a general consultation on trust law, to which the Pensions Board responded. The final report of the Commission has not yet issued but among the consultation document's proposals was the introduction of a statutory duty of care on trustees, a statutory prohibition on a trustee relying on an exemption clause for specified irreducible core functions and a prohibition on certain persons acting as trustees. In addition, it contained a proposal to allow trustees to delegate all of their functions other than some that would be reserved by statute such as, for example, a decision as to how the assets should be distributed, or a power of appointment of a trustee.
- 3.4.3 The Pensions Board's response to the Trust Law proposals is attached at Appendix A.

### **3.5 Recent UK developments**

- 3.5.1 In the UK, significant developments affecting trustees came into force with the introduction of the 2004 Pensions Act. Section 247 of that Act requires trustees to possess "knowledge and understanding" in order to properly exercise their trustee role. As well as having an understanding of the pensions legislation and trust law, trustees are also required to be conversant with the scheme documentation (e.g. trust deed and rules, statement of investment principles, explanatory literature such as scheme booklets) and have a knowledge of funding and investment principles.
- 3.5.2 The Pensions Regulator has not yet decided upon the exact reporting regime that will be put in place for trustees to demonstrate their knowledge and understanding:

*"We continue to work on the requirements to report to the Regulator, but in any event there will not be any sensible amount of learning to report under this regime until 2007, so there is plenty of time for the regulator to publish a view on these matters between now and then."*  
(Pensions Regulator 2006, 7)

- 3.5.3 As well as publishing a code of practice, the Pensions Regulator has established an e-learning system on its website to assist trustees to meet their new requirements.

### **3.6 Irish Research**

- 3.6.1 A Masters Dissertation was completed by Ciaran Lawler, a Department of Social and Family Affairs official, in April 2006. Entitled "*Does Trusteeship Contribute Positively to Pension Scheme Governance in Ireland? A Qualitative Analysis*", the research is based on semi-structured interviews with over 30 respondents, including trustees (employer-nominated, member-elected and professional), pension lawyers, social partners, officials from the Department of Social and Family Affairs, the Pensions Board, the Office of the Pensions Ombudsman, and pension industry professionals. A review of relevant trusteeship literature and further documentary analysis form the rest of the research.



3.6.2 While specific research outcomes from the dissertation are discussed in more detail under the relevant sections below, some of the key results were as follows:

- (i) Advantages of trust law for pension scheme regulation and governance centred around:
  - flexibility (in the potential for trustee discretionary decision-making and of the ability of trust law to adapt to changing circumstances);
  - the separation of assets;
  - the ability of third party beneficiaries to enforce rights;
  - familiarity with, and general understanding of, the trust concept among trustees and pension practitioners.
- (ii) Disadvantages focused on the internal governance of trust-based pension schemes and included:
  - bureaucracy, cost and time involved in administering trust-based schemes (particularly for employers);
  - potential for conflicts of interests among trustees, particularly for employer-nominated trustees of defined benefit schemes. While industry respondents were most concerned with these issues, no trustee respondent suggested that significant conflicts had emerged at the trustee board;
  - regulatory burden on trustees. This was seen as a disadvantage among industry respondents but not among most of the trustees interviewed, many of whom adopted coping mechanisms to deal with the regulatory requirements placed upon them (e.g. delegation; range of expertise represented on boards);
  - variation in the abilities of trustees to perform their functions effectively.
- (iii) Having considered these and other issues, on balance, the dissertation concluded that trust law should be retained as the fundamental underpin to the occupational pension scheme framework.
- (iv) Member trustees, where they existed, were valued for the unique contribution they made to pension scheme governance, including acting as a conduit for providing information to members. Employer-nominated trustees were relied upon for expertise in certain areas, particularly finance.
- (v) There was evidence of wide variation in awareness and understanding of trustee responsibilities.
- (vi) Ongoing, quality trustee training was the exception rather than the rule. Views were mixed among both industry experts and trustees as to whether mandatory trustee training should be introduced. Trustees were particularly enthusiastic about the potential for e-learning, along the lines of the Trustee Toolkit introduced in the UK.
- (vii) Trustees interviewed relied heavily upon advice from third party professionals. Most trustees interviewed had service level or other formal agreements in place with their advisors. This may reflect their scheme size, to some extent, as efforts to increase the number of responses from small schemes proved to have only limited success. A strong view emerged, particularly among industry interviewees, that the absence of regulatory oversight of administrators to pension schemes was a particular problem.

- (viii) There was little support for introducing remuneration for non-professional trustees.
- (ix) The issue of the provision of more proactive support for trustees, through the Pensions Board, was raised by a number of trustee respondents.
- (x) Master trusts may provide an opportunity for small, defined contribution schemes to exploit economies of scale. By effectively merging the trustee functions of smaller schemes into one operation, there may be an ability, for example, to negotiate reduced fees, eliminate the need for individual companies to commit resources to trusteeship functions, and to pool advice.
- (xi) In considering any proposed statutory indemnity for trustees, such as that proposed by the Law Reform Commission whereby trustees would be excused from liability where they have "*acted honestly, reasonably, and in good faith*", for increased clarity and certainty, the indemnity should be phrased carefully to avoid large variations in court judgements.

## **4. Specific issues**

- 4.1** As discussed at section 1.3, an outline structure for the review of trusteeship was agreed by the Board's Policy Committee and subsequently approved by the Trusteeship Review Sub-Committee established in April 2006. A range of issues were agreed for examination and, for ease of reference, this discussion document examines the issues under three main themes – External Regulation, Trustee Ability, and Internal Scheme Governance. While there is some overlap between these themes, and some items could comfortably fit into several categories, they deal broadly, and respectively, with changes to the overall regulatory structure, the ability of trustees to perform their duties competently, and relationships within the governance of pension schemes.

## 5. External Regulation

### 5.1 *The trust model and pension scheme governance*

- 5.1.1 **Key issue:** The quality of pension scheme governance has come under renewed scrutiny due to the new challenges and problems facing pension schemes across the world. In common law jurisdictions, where trustees operate as managers of occupational pension schemes, the trust model itself has been the focus of much debate. Whether trusteeship continues to contribute positively to pension scheme governance in this new environment, then, is an issue which needs to be addressed.
- 5.1.2 Recent Irish research<sup>1</sup> revealed that there were distinct advantages to the trust model, particularly in relation to separating the scheme assets from the employer, the flexibility associated with trustee discretion and trust law, the ability of third parties (e.g. a member's dependants) to enforce their rights under the trust, and the fact that it is a tried and tested model with which pensions practitioners are comfortable and familiar. In addition, the fiduciary responsibility on trustees to act in the best interests of beneficiaries was seen as a particularly strong point. Member trusteeship, in particular, provides a form of democratic representation to pension scheme members and a further layer of protection of their interests.
- 5.1.3 Disadvantages to the trust model focused on internal scheme governance, particularly the ability of trustees to manage large financial entities in an increasingly complex environment, the bureaucracy and cost (e.g. time spent on trusteeship activities) associated with operating pension scheme trusts, and the potential for conflicts of interest. It may be possible, however, to overcome some or all of these difficulties.
- 5.1.4 Trust law itself provides a context for decision-making in pension schemes, provides a framework upon which statutory legislation rests, and can act as a safety net for gaps left by prescriptive legislation. It is reasonable to conclude that trust law, in combination with prescriptive legislation, still makes a positive contribution to pension scheme governance. There are two major reasons for this. Firstly, the flexibility provided by trust law requires trustees to act with the best interests of the beneficiaries in mind, while adapting to changing circumstances. In addition, the substitution of trust law with what is likely to be a more prescriptive approach may present difficulties in that the flexible framework provided by trust law would no longer be in place to plug loopholes or gaps that, potentially, could be created through reliance on primary legislation alone.
- 5.1.5 Secondly, trust law also contributes positively to scheme governance through its ability to align the interests of the scheme stakeholders. As a simple model, we can identify the main parties within the trust arrangement as the employer, the trustees and the beneficiaries. The trustee acts as agent to both the beneficiaries and the employer. Trust law, however, seeks to overcome the possible tensions between the trustees' loyalties by legally obliging the trustee to act in the best interests of the beneficiaries while, at the same time, obliging adherence to the terms of the trust drawn up by the employer and trustees.

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<sup>1</sup> Lawler, C. (2006)

- 5.1.6 The disadvantages to trusteeship such as lack of expertise, potential conflicts of interest, and the need for further trustee support, may be overcome somewhat through a renewed focus on measures to improve the regulatory framework and the internal governance of pension schemes. The remainder of this document examines ways through which these improvements might be implemented.
- 5.1.7 The trust model, then, possesses distinct positive characteristics that set it apart from other potential arrangements. While some of its advantages (e.g. separation of assets) may also be implemented through other models, the trust model, viewed in its entirety, succeeds in providing protections both to pension scheme members, beneficiaries and employers and provides flexibility to adapt pension scheme governance to cumulative change. It is accepted, however, that the positive contribution made by the trust model may not equally apply to all types of scheme. Smaller defined contribution arrangements, for example, may not have the capacity to exploit the economies of scale enjoyed by larger schemes. While trust-based provision may provide advantages for defined benefit and larger defined contribution schemes, through the pooling of assets and a legal requirement to act in the best interests of beneficiaries, for example, these advantages may become less relevant for smaller defined contribution schemes. A small, defined contribution arrangement may be more efficiently operated through a contract-based approach, such as a PRSA, than through a single-employer-sponsored trust. Small, defined contribution schemes (those with fewer than 50 members) represent approximately 97% of all Irish schemes and approximately 20% of scheme members. Employers sponsoring such schemes can currently decide whether a contract route (i.e. PRSA) or trust-based, defined contribution arrangement provides the most efficient avenue for pension provision to its employees.
- 5.1.8 In this regard, the existence of two current models for pension provision – both contract-based and employer-sponsored trust – provides employers (and employees) with a choice of pension provision (it should be noted that different tax arrangements apply to these models). Another option, master trusts, may offer further choice and enable some of the scale disadvantages of operating trusts for small, defined contribution arrangements, to be overcome. The Board agrees, then, that the current trust model, consisting of trust law overlaid with statutory legislation, still provides a robust framework for operating occupational pension schemes. The Board recognises, however, that alternative forms of pension provision, e.g. contracts or Master Trusts (which retain the benefits of the trust-based approach but without the disproportionate costs), may provide more efficient pension arrangements for small, defined contribution schemes. The existence of several such options allows employers and employees to choose the most appropriate form of pension provision for their own circumstances.
- 5.1.9 The next section examines the master trusts model and other potential changes to the regulatory framework.

## **5.2 Professional Master Trust Arrangements**

- 5.2.1 **Key issue:** While operating pension schemes under trust provides certain advantages that may not exist under contract-based arrangements (e.g. flexibility), the relative size of a pension scheme may create difficulties. The problem of operating trusts for small, defined contribution schemes, for example, lies in the disproportionate costs (e.g. time spent by employees acting as trustees; less ability

to exploit the savings made by pooling assets; regulatory cost involved in complying with trustee responsibilities) associated with such schemes, and the view that trustees of many small, defined contribution schemes do not operate efficiently. As discussed, while contract-based arrangements may provide for cost-savings for smaller schemes, this option already exists in the form of PRSAs. An alternative arrangement – a master trust – may provide smaller schemes with the benefits of the trust-based approach but without the disproportionate costs. The potential of master trust arrangements to exploit economies of scale, thus reducing financial and regulatory costs, particularly for small, defined contribution schemes, has been cited as a particular advantage of such structures in enhancing such schemes' efficiency and effectiveness.

- 5.2.3 The potential for economies of scale in Irish pension schemes was examined by research undertaken in 2005<sup>2</sup> which revealed that a scheme with 50 members incurs costs proportionally, by reference to the number of members, 2.5 times greater than a scheme with 500 members. In addition, costs borne by smaller schemes represented 3.64% of assets compared to just 0.32% of assets in larger schemes.
- 5.2.4 Master trusts have been in operation in Australia for a number of years and allow smaller schemes to operate collectively under a single trust arrangement. In this way, the benefits of the trust approach may be maintained for small, defined contribution arrangements without the relatively excessive costs of operating each scheme under a separate trust. In addition, such a collective governance arrangement assists in pooling risks and avoids the complete exposure of an individual to a service provider.
- 5.2.5 There are over 120 master trusts operating in Australia, with the advantage of lower fees for both members and employers, and allowing for the consolidation of back-office functions and administration, thus reducing running costs. In addition, the creation of such master trusts can enable employers to maintain responsibility for providing trust-based arrangements to their employees at a lower per-member cost.
- 5.2.6 The NAPF (2006) has recently promoted the idea of 'Super Trusts' as an alternative to the UK Pension Commission's proposals on a National Pensions Savings Scheme. Super Trusts, operated on a defined contribution basis, are described as "*large, not-for-profit, multi-employer schemes managed by experts legally charged with putting the interests of members first*" (NAPF 2006, 5), and are based on the concept of master trusts outlined above. Under this model, employers would choose a Super Trust in which to enrol their employees. It would be operated on an opt-out basis with employers given the choice to run their own occupational pension scheme provided contributions matched the Super Trust minimum, the scheme was offered to all employees, annual management charges did not exceed those of Super Trusts, and a governance body to protect the interests of members was put in place. Employees, while auto-enrolled, could also opt out of the Super Trust arrangement.
- 5.2.7 Some of the advantages outlined by the NAPF are that such an approach, using a quasi-mandatory system, would significantly enhance coverage, reduce costs, increase consumer protection, and lead to simplification of the UK pensions system. In addition, the Boards of Super Trusts would consist of paid trustees who would have to demonstrate "*high levels of relevant skills and experience*" (NAPF

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<sup>2</sup> Mahon, A. (2005)

2006, 17). In order to maintain contact with individual members and employers, the NAPF also proposes that some form of advisory panel, consisting of participating employers and members, would act as a mechanism for provision of feedback to the trustees, an arrangement that has also been proposed by the Irish company promoting its own master trust concept.

- 5.2.8 Lessons learned from the operation of the Construction Federation Operatives Pension Scheme (CFOPS) need to be taken into account. Significant compliance issues have been highlighted, with employers failing to register employees and failing to deduct contributions.
- 5.2.9 In addition, there may be other drawbacks with the master trust approach. For example, and consistent with some other trust arrangements, conflicts of interest may arise where a company operating a master trust is also providing other services to the trustees. The potential of the Irish economy to absorb a sufficient amount of master trusts to enable strong competition would also need to be examined.
- 5.2.10 Having considered the issues involved, the Board decided to await further industry development in relation to Master Trusts before considering any additional regulatory action that may be required.

### **5.3 Possible extension of legal framework (to include alternatives to trusts)**

- 5.3.1 **Key issue:** The transposition of the IORPs Directive provides an opportunity for Ireland to gain a competitive advantage in attracting interested parties in other Member States to sponsor pension provision in this country. The need to extend Ireland's legal underpin for pension provision beyond trusts may need to be considered to enhance our competitiveness in the cross-border pensions market by providing access to pension provision in a non-trust legal form with which sponsors may be familiar.
- 5.3.2 Recognising that considerable interest has already been expressed by parties in other EU Member States to sponsor pension provision in Ireland, and given that the Directive has been in place less than a year, it may be premature at this point to extend our current legal arrangements. Accordingly, a 'wait and see' approach may be the most suitable option, assessing the need for extension of the legal framework against demand.
- 5.3.3 The Board decided that the issue of extending the legal framework beyond trusts to accommodate alternative forms of pension provision in the context of IORPs should be considered on a demand-led basis.

### **5.4 Regulation/Registration of Administrators**

- 5.4.1 **Key Issue:** Third party administrators are currently unregulated in terms of the scheme administration work carried out on behalf of trustees. This is primarily because there are no formal qualifications for administration and no benchmark against which standards are currently measured. Feedback, and our own experience, suggests that, in some cases, the standards of administration are

poor. This is also the experience of the Pensions Ombudsman as evidenced in his annual reports.

- 5.4.2 While it is the trustees' responsibility to monitor the performance of their delegates, they may find it difficult to monitor the administration standards on an ongoing basis, or may find a problem some time after an error or breach has been made. It has also been suggested that trustees attend disproportionately to actuarial/consultancy issues at the expense of scheme administration, particularly in defined contribution schemes.
- 5.4.3 Research undertaken in 2006<sup>3</sup> found that, among a small sample surveyed, the absence of any regulatory oversight of pension scheme administrators was seen as a particular problem by both industry experts and a small number of trustees interviewed. There was particular concern among some respondents about the standards of administration in the industry.
- 5.4.4 The suggestion that a new role of "registered administrator" be introduced first emerged during Pensions Board discussions in May 2003. While statutory regulation of administrators may ensure greater accountability, it may also reduce the burden of regulatory oversight by focusing the activities of the Board, in this area at least, on the small number of companies providing administration services rather than the thousands of schemes that exist. If a particular company providing administration services was seen to be persistently failing in a random selection of schemes, for example, further investigations into its scheme administration may be carried out. By focusing on the administrators, it raises the probability of identifying those schemes where administration standards are failing, compared to a random selection of schemes alone. Any such regulation, however, would need to be balanced in ensuring that trustees uphold their trust law duty to monitor the activities of those to whom they delegate functions, assisted, as outlined below, through service level agreements.
- 5.4.5 It would be appropriate, therefore, that scheme administrators (including larger companies that provide their own administration services to the trustee board of their occupational pension scheme) are required to register with the Pensions Board who would have responsibility to audit administration service standards (which would require some form of statutory underpin) and to remove registration or apply sanctions if required standards were not met.
- 5.4.6 Powers may already exist under Section 18 of the Act to apply such auditing activity to scheme administrators. Section 18(1) states:
- "The Board may authorise in writing such and so many persons as it considers necessary to be authorised persons to inspect or investigate on its behalf the state and conduct of a scheme or the state of a PRSA product."*
- 5.4.7 Duties to provide information, documents material or explanation to the authorised person, according to section 18(4), extend to *"any person being an officer or employee of the employer or the PRSA provider in relation to its activities as such a provider or a trustee or agent, as the case may be ..."*

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<sup>3</sup> Lawler, C. (2006)



- 5.4.8 Section 18(6) declares that the definition of agent “*includes the actuaries, administrators, auditors and other accountants and the financial and other advisers to the scheme or a PRSA provider.*”
- 5.4.9 In this regard, powers already exist for the Board to enter the premises of administrators and request or inspect documentation relating to a scheme. However, the use of section 18 is currently limited to serious investigations and not for ongoing monitoring. It may be more appropriate, therefore, to include another specific power in the Act, perhaps similar to the disclosure requirements of section 54.
- 5.4.10 In order to assess standards, there needs to be a benchmark against which such standards can be measured and assessed. In relation to trustee duties, it has been suggested that, in order to raise standards among those to whom trustees delegate, service level agreements (between trustees and their delegates) should be considered as a compulsory requirement. This may achieve higher standards, while maintaining trustee responsibility to fulfil their statutory functions and increase awareness among trustees of their core responsibilities. Using such an agreement as a benchmark, failure to fulfil the requirements of the service level agreement between the trustee and administrator may trigger sanctions as outlined above. In addition, while delegated administration activity would now come under the scope of statutory regulation, the trust law duty for trustees to monitor those to whom functions have been delegated remains and, indeed, is enhanced through using the agreement as a monitoring tool.
- 5.4.11 The Board considered whether a lighter regulatory approach should be adopted, requiring administrators to report on activities to the Pensions Board. For example, the administrators may be required on a quarterly basis to provide details to the Board on, for example, the number/names of pension schemes to which they provide administration services, the number of annual reports produced (including those due and which were not issued), number of benefit statements due to be issued but were not, etc.
- 5.4.12 In the context of low administration standards, however, the Board concluded that an approach along the lines suggested in 5.4.10 above may not achieve the desired results. While benefit statements may be issued on time, for example, their content may be erroneous. In this regard, recognising the need for trustees to dedicate higher priority to the administration of their pension schemes, the Board decided that an approach requiring compulsory service level agreements between trustees and administrators, in tandem with auditing and disciplinary powers attached to the Board, provides the most appropriate response.
- 5.4.13 While it is necessary to legislate for the introduction of compulsory service level agreements between trustees and administrators, the Board decided that the level of prescription involved should remain proportionate. The Statement of Investment Policy Principles is recommended as a model approach. Guidance on the appropriate content of the service level agreements in the form of a template may be issued by the Pensions Board.

## **5.5 Relationship between trustees and service providers (other than administrators)**

- 5.5.1 **Key Issue:** Apart from administrators, trustees enter into other third party relationships for services, including with investment managers and accountants. Trustees generally rely heavily on these services. This may lead to potential problems whereby information asymmetries exist between the trustees and those from whom they seek such advice and services. While there is a tendency for larger schemes to have service level or other formal agreements with their advisors in place, the practice appears to be less widespread among smaller schemes in particular. The key issue is whether service level agreements between schemes and their service providers should be made compulsory.
- 5.5.2 As already mentioned, service level agreements may provide the opportunity to assist in ensuring that standards are met, that a specified level of service is achieved through providing the incentives to third party service providers to align their interests with those of the trustees in a contractual arrangement, and that trustees are more aware of the questions that they should ask of their delegates. The Board's 'Codes of Practice for Trustees' (2004, 18) already states that trustees should "*put a service level agreement in place when delegating any of their functions to any person or organisation*".
- 5.5.3 In the UK, while stopping short of requiring a service level agreement, it is compulsory under the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (No.1715) to have a written notice of appointment between the trustees and the professional advisors, setting out the date the appointment is to take effect, to whom the advisor is to report, and from whom the advisor is to take instructions.
- 5.5.4 Section 96 of the Act already requires PRSA providers to enter into contractual arrangements with service providers such as investment managers, auditors, administrators and actuaries.
- 5.5.5 In relation to occupational pension schemes, Article 13(b) of the IORPs Directive requires the Board to "*supervise relationships between the institution and other companies or between institutions, when institutions transfer functions to those other companies or institutions (outsourcing)*". In this regard, the introduction of mandatory service level (or other contractual) agreements between trustees and service providers may, in conjunction with section 18 of the Act, assist the Board in performing this supervisory function. As stated in section 5.4.9 above in relation to third party administrators, this may assist in increasing standards of governance while maintaining trustees' responsibility to monitor the actions of their delegates.
- 5.5.6 In relation to this latter point, that is, the monitoring of third party delegates, the NAPF (2006a) has also pointed to how such written agreements can be used to provide for effective performance measurement:

*"Any ongoing services or significant project work with third parties should be supported by written agreements, for example, formal contract, service level agreements (SLAs) or a detailed written brief. This not only establishes expectations between both parties, but also provides the basis*

*for performance measurement and helps to identify the key performance indicators.”*

(NAPF 2006a, 17)

- 5.5.7 In this regard, the NAPF (2006a, 18) identifies key scheme-specific measures such as performance against service level agreements, judgements of the quality and effectiveness of the advice, perhaps in comparison with an alternative adviser, speed of response, clarity of information, and value for money as providing a benchmark against which to assess third party providers.
- 5.5.8 In addition, the NAPF proposes a model through which trustees should conduct self-assessment, including self-review, peer appraisal, and appraisal from those with whom trustees work. Also, the Myners Report concluded that compliance with performance measurement was weak. It stated that formal reviews were undertaken only by a minority of schemes and that formal self-assessment of trustees was rare. It may be, therefore, appropriate that trustees should undertake formal assessments of their own procedures and decisions as trustees and arrange for formal assessments of procedures and decision-making delegated to third parties. An approach such as this, recommending best practice, could form part of a recommended code of governance appended to the Trustee Handbook, as also mentioned under section 7.1.7 below. In addition, a trustee self-assessment form could be included in the trustee annual report in the form of a trustee duties checklist.
- 5.5.9 The Board considered the option of introducing compulsory service level agreements between trustees and third party service providers (other than administrators). The Board decided that there were significant differences in the relationship between trustees and these third parties as opposed to that between trustees and administrators, e.g. the service provided by other third parties is often intermittent rather than continuous. In addition, other third party professionals are often directly regulated or self-regulated.
- 5.5.10 On balance, the Board decided that continuing the approach of encouraging service level agreements is the most proportionate response. Given that the standards of advice and services have not been assessed across the industry, and that trustees' trust law duty to monitor their delegates and advice received remains, it is more appropriate to encourage such monitoring rather than require it in a standard, prescribed format.
- 5.5.11 The Board also decided that the inclusion of a trustee self-assessment form in the trustee annual report would not add value to trustee performance and may be too subjective an approach. Accordingly, such a measure is not recommended.

## **5.6 Position of Employer as Sole Trustee**

- 5.6.1 **Key Issue:** Where an employer acts as sole trustee, the potential for conflict of interest rises significantly, particularly in the case of non-payment of contributions. As it is the responsibility of the employer to ensure the contributions are paid, and the employer is also the trustee, the members do not have the additional layer of protection usually provided by trustees. Perhaps more significantly, employers acting as sole trustee are often unaware that they are acting as the trustee and are unaware of their role and responsibilities.

- 5.6.2 The National Pensions Policy Initiative (NPPI) (1998) stated that while it is sometimes argued that trust law provides more protection than contract law, this is less clear when considering small, defined contribution arrangements, particularly where the employer acts as trustee:

*“Relying on an employer as trustee to ensure that pension assets are clearly separated from company assets and to whistleblow on itself may provide limited security.”*

(Pensions Board 1998, 141)

- 5.6.3 The Board concluded at the time that the issue be kept under review.
- 5.6.4 While the Board agreed, in principle, that an arrangement whereby the employer acts as sole trustee is far from satisfactory, the ability to find suitable, practical alternative options proved difficult. Requiring an independent trustee to be appointed, for example, would impose a significant cost burden on schemes. In addition, requiring a second trustee in all cases may be problematic as it may be difficult to find persons willing to take on the role.
- 5.6.5 The Board considered that recommended changes elsewhere in this report, including the introduction of regulation of administrators and improvements to the training regime, in tandem with existing provisions requiring whistleblowing where non-remittance of contributions takes place, may provide the additional protections necessary to overcome some of the difficulties associated with this arrangement. Accordingly, the Board decided to keep the issue under review in the context of these proposed developments.

## **5.7 Possible role of an “independent trustee” of schemes**

- 5.7.1 **Key issue:** The potential need for the appointment of an ‘independent trustee’ may arise when a sponsoring employer is in liquidation and had been acting as the sole trustee. Such a need may arise due to the significant potential for conflicts of interest between the employer’s duties to his creditors and the trustees’ duties to beneficiaries. (3,929 companies were in the course of liquidation in 2004, according to the Companies Registration Office, although we are not aware of how many were operating occupational pension schemes.)
- 5.7.2 In the UK, the Social Security Act 1990, introduced such a provision, stating that the insolvency practitioner or official receiver has a duty to “*satisfy himself that at all times at least one of the trustees of the scheme is an independent person*” and, if he or she is not so satisfied, “*to appoint [...] or to secure the appointment of, an independent person as trustee of the scheme*”.
- 5.7.3 ‘Independent’, in this context, is defined as someone who:
- has no interests in the assets of the employer or of the scheme, otherwise than as trustee of the scheme;
  - is neither connected with, nor an associate of –
    - (i) the employer;
    - (ii) any person for the time being acting as an insolvency practitioner in relation to the employer; or
    - (iii) the official receiver acting in a capacity of “*the liquidator or the provisional liquidator of a company which is the employer of any*”

*such persons” (i.e. the employer of scheme members) or “the receiver and the manager, or the trustee, of the estate of a bankrupt who is the employer of any such persons”.*

5.7.4 These provisions were reinforced through the UK’s Pensions Acts of 1995 and 2004. Significantly the duty of the insolvency practitioner to ensure that an independent trustee is in place is repealed. It is now at the discretion of the Pensions Regulator whether to appoint an independent trustee in such circumstances. The Regulator holds a register of persons/bodies who can act as trustee, subject to fulfilling certain requirements (e.g. sufficient relevant experience of occupational pension schemes, is a “fit and proper person to act as trustee”, and operates sound administrative and accounting procedures.)

5.7.5 There may be scope under Article 14 of the IORPs Directive to introduce such a provision in the Act, particularly Article 14(3) which states:

*“In order to safeguard the interests of members and beneficiaries, the competent authorities may transfer the powers which the persons running an institution located in their territories hold in accordance with the law of the home Member State wholly or partly to a special representative who is fit to exercise these powers.”*

5.7.6 Given that potential for conflicts of interest have been identified as a potential problem for trustees in other areas of this discussion document, the situation where a sponsoring employer, who had been acting as sole trustee, goes into liquidation would seem to present a concrete situation where conflicts may become explicit and not redeemable through the provision of guidance or advice. Rather, the significant potential for conflict of interest in this circumstance may require the need for regulatory intervention. However, it is also recognised that the appointment of such trustees would require payment of fees from the scheme funds and could put a significant and disproportionate drain on such schemes.

5.7.7 The Board decided that the appointment of an independent trustee in these circumstances may impose a disproportionate burden on scheme assets. In this regard, it was decided that the Act should include a provision to allow the Board to exercise discretion in either appointing such a trustee or else authorising the administrator to carry out the wind-up. Legal advice (particularly on indemnity issues) may be required if proceeding with this option.

## **5.8 Appointment of trustees where none exist**

5.8.1 **Key issue:** Section 64 of the Act allows the Pensions Board to appoint trustees to a scheme where there are no trustees or the trustees cannot be found. There are outstanding issues relating to the use of this power which need to be considered, i.e. the sourcing of suitable trustees, indemnification and fees.

5.8.2 In relation to sourcing of suitable trustees, a first scenario is that the Board draw upon a register, where independent trustees can be called upon to act in cases where trustees cannot be found. Again, discretion would need to be exercised in such cases, recognising the potential drain that trustee fees might place on the fund.

- 5.8.3 Indemnification issues also arise, particularly where trustees on the register are not corporate trustees, as the Act does not provide any indemnification for trustees so appointed. As such, trustees appointed by the Board would be open to being sued like any other trustees and there is an argument that the Act should provide indemnification. Lack of such cover may cause difficulties in sourcing trustees as individuals may be reluctant to become trustees without some form of indemnity or insurance.
- 5.8.4 One approach may be to provide a statutory indemnity for trustees appointed by the Board. Section 61 of the UK's Trustee Act 1925 provides a statutory indemnity for trustees who have "acted honestly and ought fairly to be excused for breach of trust", although this indemnity is at the discretion of the court. A similar provision has been proposed by the Law Reform Commission in its "Consultation Paper on Charitable Trust Law – General Proposals". The Commission has recommended that the court should be given discretion to excuse trustees from liability where they have "acted honestly, reasonably and in good faith". There is potential for such an approach to attract 'lay' trustees to take up the position. Affording a large amount of discretion to the courts, however, in determining when liabilities may be exonerated may lead to inconsistency in decision-making and greater uncertainty. In this regard, any statutory indemnity would need to be carefully worded to lessen the possibility of such wide variations in decisions.
- 5.8.5 Having considered the issues, the Board decided to keep this issue under review, particularly because it is not an issue that arises often and existing provisions have proved largely satisfactory.

## 6. Trustee Ability

### 6.1 *Possible extension of IORPs trustee requirements*

- 6.1.1 **Key issue:** As discussed previously, a more complex legislative and investment environment has placed new demands on trustees, encouraging a renewed focus on their ability to manage pension schemes. Trustee ability, or trustee knowledge and understanding, has thus emerged as a significant issue in recent years, some commentators suggesting that a lack of ability has impacted negatively on the administration and investment performance of pension schemes. One option to increase standards is the introduction of mandatory training, as set out in section 6.2 below. An alternative, or parallel, option is to extend the IORPs trustee requirements.
- 6.1.2 The IORPs Directive, as transposed, introduced new trustee requirements. The Occupational Pension Schemes (Trustee) Regulations 2006, (S.I. No. 293 of 2006) require that trustees who do not enter into an arrangement with an investment manager to provide an investment service in respect of the investment of the resources of the scheme, must satisfy the Board that they possess qualifications and experience appropriate and relevant to investment of the resources of the scheme or have entered into arrangements with advisers possessing the necessary qualifications and experience.
- 6.1.3 The requirements placed upon trustees were extended in the UK when Trustee Knowledge and Understanding (TKU) requirements were introduced on foot of the UK's Pensions Act, 2004. TKU, which came into effect in April 2006, requires that trustees have knowledge and understanding of the law relating to pensions and trusts, as well as funding and investment principles. Trustees should also be "conversant" with their own scheme documents.
- 6.1.4 Under the TKU approach, trustee boards have to provide evidence, in their scheme returns, to the Pensions Regulator on steps they have made to comply with the TKU requirements and what steps they have taken to address any gaps in such knowledge. Unlike the Irish requirements on investment, TKU requires such knowledge and understanding from each trustee.
- 6.15 Any decision to extend the IORPs requirements needs to be considered in tandem with any decision on mandatory training. If a mandatory approach to training was adopted, for example, the need for extending the IORPs requirements may not be necessary. Research has revealed, however, that knowledge and understanding among trustees varies greatly, and that training is sporadic and unstructured. In the absence of mandatory training, therefore, some extension of trustee requirements to ensure increased knowledge and ability may be required. As these issues should be dealt with together, options for action are presented after the next section which deals with the training issue.

## 6.2 Trustee Training

6.2.1 **Key Issue:** While trustees are required to disclose whether they have access to trustee training in the annual report, the body of research on this issue reveals that continuous, quality training is not the norm. In seeking to drive up levels of ability and understanding among trustees, it remains an option to introduce automatic training for trustees in order to increase standards. The delivery of such training, and the supporting infrastructure, as well as the potential costs to the schemes, present the most significant challenges to its introduction.

6.2.2 In recent years, the issue of trustee ability has gained greater prominence. In 1993, the UK's Pension Law Review Committee (the "Goode Report") devoted little attention to the area of trustee knowledge and training, simply suggesting that good practice should determine that trustees complete a preparatory training course and undergo continuous training in relation to scheme management and their responsibilities. Eight years later, the Myners Review (2001), while concentrating on investment issues, saw trustee skill levels as crucial for effective performance:

*"... there should be a legal requirement that where trustees are taking a decision, they should be able to take it with the skill and care of someone familiar with the issues concerned. [...] If they do not feel that they possess such a level of skill and care, then they should either take steps to acquire it, or delegate the decision to a person or organisation who they believe does possess this level of skill and care."*  
(Myners 2001, 44)

6.2.3 Myners concluded that better access to good quality trustee training, with proactive involvement by trustees in updating themselves on changes in pensions law, would enable trustees to manage schemes in a more business-like manner. It is clear that, even since the early 1990s, the issue of trustee ability and training has become more prominent. The IORPs Directive's requirement that a pension scheme *"is effectively run by persons of good repute who must themselves have appropriate professional qualifications and experience or employ advisers with appropriate professional qualifications and experience"* seems to echo Myners' conclusion and seeks to ensure that ability and experience is inherent to the decision-making processes of trustees.

6.2.4 In the Pensions Board's experience, trustees' level of ability, and the type of skills they possess, varies greatly. Recent research<sup>4</sup> findings emphasise the importance of training for trustee development, particularly as most trustees surveyed attended initial training upon becoming a trustee and considered it useful. But follow-up training was rare and, in cases where it did exist, was often sporadic and unstructured. The research suggested that ongoing, quality training was the exception rather than the rule. Employer-nominated trustees were generally satisfied with the training they received upon taking up the trustee role, but the majority did not attend any further courses or training sessions. Member trustees attached great value to training but gaining access to courses was an issue for some.

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<sup>4</sup> Ibid.



- 6.2.5 These results also coincide with results from quantitative research carried out by the Pensions Board in 2003. It found that 75% of trustees undertook a training course within 12 months of their appointment. 65% indicated that member trustees did not receive additional or specialised training, and 71% of respondents did not receive “refresher” courses.
- 6.2.6 Views were mixed among both industry experts and trustees in Ciaran Lawler’s research as to whether trustee training should be introduced on a mandatory basis. Although expressed by a minority, issues relating to proportionality for smaller schemes and further regulatory complexity were arguments against the introduction of compulsory trustee training. Among trustees, attitudes varied towards the issue, some preferring an approach which encouraged training with others favouring the compulsory approach, particularly upon appointment – or even prior to this.
- 6.2.7 Lawler’s conclusion was that the voluntary approach to training had failed and that a new approach needed to be strongly considered. In this regard, he recommended that mandatory training be introduced for, at the very least, all new trustees. Such an approach would be supported by an e-learning system, similar to that adopted in the UK, and compulsory reporting on the level and type of training received would be included in the trustee annual report. He suggested that such an approach would not introduce a disincentive effect on take-up of trustee positions *“given the fact that the research suggests that member trustees, particularly, are anxious to receive ongoing training but find it difficult to access due to geographical, work or time pressures.”*
- 6.2.8 The introduction of e-learning by the UK’s Pensions Regulator may be viewed as an appropriate mechanism for basic trustee training for a number of reasons. Firstly, it would assist in overcoming the geographical obstacles to training attendance. Secondly, it would provide a solution for those that generally find it difficult to spare time to attend training courses. Thirdly, it is relatively low-cost (provided free to trustees in the UK).
- 6.2.9 The Pensions Regulator’s e-learning programme, the “Trustee Toolkit”, is a modular interactive programme which trustees can access and use when they wish. It records progress that each individual has made and is designed to increase trustees’ awareness of their roles and responsibilities, using real-life scenarios, with assessments at the end of each module to determine remaining gaps in knowledge. Trustees who were asked about such a system in Ciaran Lawler’s research were extremely positive towards it and suggested that a properly designed PC-based tutorial training system would be beneficial for trustee development. Interactivity was deemed important to ensure that such training was engaging and relevant to various scheme types.
- 6.2.10 In a similar vein, the UK’s National Association of Pension Funds operate a web-based “Training Needs Analysis” programme for trustee boards. This multiple-choice exercise is intended to guide trustee boards in identifying individual and collective gaps in knowledge and understanding.
- 6.2.11 Currently, the Occupational Pension Schemes (Disclosure of Information) Regulations, 2006, require that the annual report includes a statement as to whether trustees have access to appropriate training on their duties and responsibilities. The Board considered this provision to be inadequate and decided that it should be replaced by a requirement that the annual report should

include a statement by the trustees on what training has actually been arranged and received.

- 6.2.12 To support this provision, the Board decided that legislation should be introduced so that employers are obliged to arrange trustee training for each individual trustees within six months of their appointment and at least every two years thereafter. Training options should include e-learning, regional “beginner” and refresher training, and the Trustee Forum. The Forum should be encouraged to hold regional seminars and trustee training providers generally should hold training courses regionally to overcome geographical barriers. In addition, the course offered by the Irish Institute of Pension Managers – The Trustee Certificate of Essential Pensions Knowledge – offers trustees the opportunity to receive a formal qualification as part of their training regime. Training courses should be kept up to date, reflecting any relevant changes in legislation or trustee duties and the Board should maintain its role of monitoring the quality of trainers and training content (including, for example, trustee ethical behaviour, service level agreement).
- 6.2.13 The Board also recommends, as best practice, that all trustees should attend training together, as far as practicable.
- 6.2.14 The Pensions Board has drawn up a register of approved trustee training courses which is available on the Pensions Board website [www.pensionsboard.ie](http://www.pensionsboard.ie).
- 6.2.15 In addition, the Board decided that it should be compulsory for every scheme to have a copy of the Pensions Board’s Trustee Handbook. The Board also recommends, as best practice, that all trustees of a scheme should have a copy of the Pensions Board’s Trustee Handbook.

### **6.3 Trustee Remuneration**

- 6.3.1 **Key issue:** It has been suggested that providing remuneration to trustees may assist in achieving higher standards of ability. Recognising the additional responsibilities placed on trustees in the modern pensions environment, Myners (2001) suggested that trustees should be remunerated in some way for performing their duties.
- 6.3.2 The view among industry respondents interviewed for Ciaran Lawler’s research, however, did not support this course of action. Firstly, it was claimed by many respondents that providing payment to trustees for their work may attract people to the post for negative reasons. These respondents emphasised the value placed upon the voluntary approach, whereby trustees take up their positions based on experience, expertise or a sense of duty. A minority of respondents commented that, if trustees were remunerated, it would place a higher duty of responsibility upon them in court, exposing them to claims of negligence that may not otherwise hold. Others stated that remunerating trustees would add costs to the pension scheme which were not warranted. Several respondents stated that it was questionable whether paying trustees would raise skills levels. Most suggested that payment of expenses and paid time off to perform trustee duties was more important than any type of salaried payment, a view that was shared by virtually all trustee respondents.

- 6.3.3 Among trustees, there was virtually no support for trustee remuneration. In the main, this view related, again, to the idea that trustees generally volunteered for their role or felt a responsibility to take on the role as part of their general work duties. In addition, trustees did not tend to spend time on trustee duties in addition to their ordinary work hours, with trustee meetings and training occurring during the normal working day. While some trustees stated that they should be paid for out-of-pocket expenses incurred in the course of performing their roles, several suggested that remuneration would result in a different category of person applying for the role, and for financial reasons, rather than a sense of duty or obligation, further reflecting trustees' understanding that their role was one of fiduciary responsibility.
- 6.3.4 Since there is no evidence to suggest that trustee performance would be increased by introducing remuneration, and payments would add additional costs to schemes already in financial difficulties, the Board decided that it is more appropriate to promote, as best practice, that trustees should be supported financially in their role through the provision of compensation for expenses incurred and provided with adequate paid time off for trustee duties and trustee training, as appropriate.

## 7. Internal Scheme Governance

### 7.1 *Relationship between trustees of the same scheme*

- 7.1.1 **Key Issue:** The relationship between scheme trustees is an area of concern in relation to potential conflicts of interest which may arise depending on the different sources of trustee appointment (i.e. member-elected/employer-appointed trustees).
- 7.1.2 Trustees are the focus of decision-making in Irish occupational pension schemes. As discussed previously, the quality of this decision-making has been questioned in recent years, particularly as more defined benefit schemes have moved into deficit situations. In this regard, the role of the trustee as 'gifted amateur' has been raised as an obstacle to proper management of a more complex and unpredictable environment, particularly around investment issues.
- 7.1.3 In examining the composition of the boards of trustees interviewed for his research, Ciaran Lawler found that they do not consist predominantly of amateurs, but rather present a mix of professional skills and other attributes, purposely chosen by employers and members to bring such skills to the trustee table. In addition, professional trustees are also regular participants on trustee boards, bringing an experience in trustee practice that was deemed particularly valuable by those trustees interviewed on whose boards they sit.
- 7.1.4 The professional skills possessed by employer-nominated trustees centred around finance, investment and accountancy. The financial director of a firm was often nominated to the trustee board and these trustees generally cited their financial skills as appropriate and valuable in the performance of their trustee functions. Employer-nominated trustees were usually located in the senior management of the firm.
- 7.1.5 Significantly, when it came to making key decisions at the trustee table, the research suggested that votes were extremely rare, even in situations where there were both member trustees and employer-nominated trustees. In addition, it was common that the employer-nominated trustees would research a particular topic, for example, around investment strategy, and present the results of such research, including recommendations, to the trustee board for decisions. Employer-nominated trustees were often the board members who drove the process of decision-making, although member trustees did not see this as a problem.
- 7.1.6 Lawler also pointed out that some employer-nominated trustees were concerned that member trustees were sometimes unable to separate the role of trustee and worker representative and brought issues unrelated to the trustee board to its meetings. Often, this would involve member trustees raising questions about the level and type of benefits offered or discussions that were more relevant to employer and union negotiations. This was often attributed to a lack of trustee experience and was dealt with at board level by referring such matters to employer and union representatives.
- 7.1.7 As stated above, however, while the potential for conflicts of interest was recognised, Lawler's research suggested that such conflicts were uncommon events among the trustees interviewed. However, he suggested that a model code

of governance be appended to the Trustee Handbook to assist trustees presented with conflicts of interest. Having considered the matter, the Board decided that the Trustee Handbook already provides sufficient guidance in this regard. However, a “trustee checklist” should be appended to the next edition of the Handbook to assist trustees in meeting their obligations.

## **7.2 Relationship with employer**

- 7.2.1 **Key issue:** The revised accounting treatment for pensions in company accounts, together with increasing employer costs required to maintain scheme solvency, has resulted in a closer interest by employers in the operation of schemes. Consideration may need to be given to whether scheme trustees should be required to consult the sponsoring employer in relation to such key aspects of scheme operation as, for example, investment of scheme assets.
- 7.2.2 Since 2005, following the introduction of the new accounting standard, FRS17, pension fund liabilities are required to be included on company balance sheets. This introduced significant changes to the way deficits (or surpluses) in defined benefit schemes were accounted for, and brought the employer’s business more closely towards that of the pension fund. Using prescribed actuarial assumptions, the surplus or deficit should be recorded on the company balance sheet. Large deficits result in lower company profit declarations and, accordingly, may bring lower dividends for shareholders.
- 7.2.3 In this regard, the issue of employer as trustee of defined benefit schemes has become more significant in recent years. Recent research<sup>5</sup> underlines this view and suggests that, in the UK, defined benefit pension schemes with a high proportion of employer-nominated (insider) trustees invest a higher proportion of assets in equities and contribute less to the pension fund. In addition, the study found that dividend payouts for these firms were higher. The research concluded that the presence of such proportions of “insiders” create problems whereby the employer-trustees favour the shareholders of the firm over the plan beneficiaries.
- 7.2.4 Ciaran Lawler’s research, however, found little evidence from trustees, either employer-nominated or member-elected, that conflicts of interest presented a significant difficulty in the operation of their pension schemes. While some employer-nominated trustees acknowledged that there was potential for conflicts of interest, no respondent suggested that significant conflicts had emerged during decision-making at the trustee board. In fact, several employer-nominated interviewees suggested that the presence of member trustees provided protection against the emergence of such conflicts, with others outlining informal strategies that were adopted to ensure that conflicts did not emerge.
- 7.2.5 However, the research also concluded that the ongoing interests of the employer in the pension fund is something that trustees should bear in mind when making decisions. The research cited two lines of case law developing in the UK on this issue. One line of decisions suggests that employers’ interests should be considered by the trustees, while another suggests that, while the purpose of trustees is to act in the best interests of the beneficiaries, a decision to take the interests of the employer into account can be made in extreme circumstances.

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<sup>5</sup> Cocco and Volpin (2005)

- 7.2.6 In a UK case, *Edge v Pensions Ombudsman*, which considered the distribution of a pension fund surplus, a broad view was taken that the interests of the employer should be considered part of the trustees' fiduciary role. The following extract from the decision outlines this wider view:

*"[The trustees] must, for example, always have in mind the main purpose of the scheme – to provide retirement and other benefits for employees of the participating employers. They must consider the effect that any course which they are minded to take will have on the financial ability of the employers to make the contributions which that course will entail. They must be careful not to impose burdens which imperil the continuity and proper development of the employer's business or the employment of the members who work in that business. The main purpose of the scheme is not served by putting an employer out of business."*

(*Edge vs Pensions Ombudsman* [1999] 4 All ER 546 (CA): p.566)

- 7.2.7 A narrower view was taken in the *Hagen v ICI Chemicals* case ([2002] IRLR 31) which dealt with wind-up issues. The ruling stated that trustees' fiduciary obligations were to the members of the scheme, although extreme circumstances (such as the employer being in a particularly unhealthy financial situation) may necessitate the employers' interests being taken into account.
- 7.2.8 While UK decisions are obviously not enforceable in this jurisdiction, they are of persuasive authority. In this regard, and in the absence of sufficient Irish case law, it may be appropriate that trustees should be provided with guidance articulating the importance of consulting with sponsoring employers, and keeping their interests in mind, when making key decisions at the trustee board. Such guidance would need to emphasise, however, that the ultimate driver behind trustee decision-making is the best interests of beneficiaries. The Board decided that such guidance should be included in trustee training.

### **7.3 Member Trustee Regulations**

- 7.3.1 **Key issue:** It was agreed that, while a review of detailed provisions of the Member Trustee Regulations is a separate exercise, the review of trusteeship could deal with the principles which should underlie member trusteeship.
- 7.3.2 The research undertaken by Ciaran Lawler showed that the appointment of trustees, or their volunteering for appointment, often owes as much to a sense of obligation, particularly among member trustees, than to any empirical measure of their ability or decision-making standards. With regard to employer-nominated trustees, the sense of obligation due to the position held within the company, as well as the skills, usually financial, appropriate to that position are the drivers behind such appointments.
- 7.3.3 Opinions varied among employer-nominated trustees interviewed on the skills that member trustees brought to the trustee board. While most saw member trustees as often offering valuable perspectives beyond that which is provided by company management, others felt that member trustees needed to be assisted with some elements of trustee decision-making, particularly on investment issues.
- 7.3.4 It was evident from the research that the principle of member trustees had been accepted by all trustees interviewed, with many outlining the positive contribution

that such trustees can bring to the trustee board. Of those schemes without member trustees, all of these respondents stated that member trustees would be welcomed to the trustee board if there was sufficient interest among scheme members.

- 7.3.5 Where it suited the particular structure of needs of the company and its employees, employers and unions sought to reach agreement on a selection process outside of the Member Trustee Regulations. The existence of the Regulations in their current form did not impede the appointment of member trustees in any of the trustee interviewees' schemes.
- 7.3.6 The research evidence also suggests that member trustees play an active and unique role in pension scheme governance. Given that many member trustees are non-professionals and non-experts, Lawler concludes that trusteeship, generally, amounts to more than a base of knowledge for decisions around investment and adherence to prescriptive regulation. Rather, he suggests, member trustees, particularly, act as intermediaries in the interface between service provider and employee, channelling information to scheme members in a role which has the flexible capacity to serve in member's best interests in varied and changing circumstances.
- 7.3.7 The Pensions Board is committed to reviewing the Occupational Pension Schemes (Member Participation in the Selection of Persons for Appointments as Trustees) (No.3) Regulations, 1996 (S.I. No.376 of 1996), and the above summary of research findings should inform the review process.

## **8. Summary and Conclusions**

- 8.1** In assessing whether trusteeship should continue as the fundamental regulatory underpin to occupational pension schemes in Ireland, the Board came to an early conclusion that the trust model continues to offer protections to pension schemes that justify its continuance. While alternatives, particularly contracts, may be appropriate in certain arrangements, such as small defined contribution schemes, choice already exists in this regard in the form of PRSAs.
- 8.2** In a changing pensions environment, however, and recognising the difficulties that face pension schemes today, the Board considered that there were some improvements that could be made at this point in an effort to ensure that the regulation and governance of trust-based occupational schemes continues to offer those protections. In making its decisions, the Board remained aware that changes to the regulatory regime should be made in a proportionate manner and only where necessary. In this regard, several issues are being kept under review. The recommendations in this report aim to enhance the governance of occupational pension schemes and member protection.
- 8.3** In relation to the regulation of occupational pension schemes, the main recommendation is to introduce regulation to enhance standards of scheme administration. This includes the introduction of compulsory service level agreements between trustees and scheme administrators and new auditing and disciplinary powers for the Pensions Board in this regard. In addition, in aiming to increase standards of trustee ability, the Board recommends that employers are obliged to arrange trustee training for all new trustees within six months of their appointment and to arrange refresher courses at least every two years. Enhancements to the guidance offered to trustees also aims to increase standards of governance within pension schemes.
- 8.4** The next section outlines the main recommended actions in this report, allocates responsibility for their implementation, and suggests an appropriate timeline for their introduction, where appropriate, should the Minister accept the Board's recommendations in this regard.



## 9. Table of actions, including location of responsibility and timeline

<b><u>ACTIONS</u></b>	<b><u>RESPONSIBILITY</u></b>	<b><u>TIMELINE</u></b>
Monitor further industry developments in relation to Master Trusts before considering any additional regulatory action	Pensions Board / DSFA	Ongoing
The issue of extending the legal framework beyond trusts in the context of IORPs is to be considered on a demand-led basis	Pensions Board / DSFA	As required
Introduce legislation to enable the registration and audit of administrative activities of pensions administrators and sanctions for non-compliance	Pensions Board / DSFA	Social Welfare and Pensions Act, 2008
Introduce compulsory service level agreements between trustees and administrators through legislative amendment	Pensions Board / DSFA	Social Welfare and Pensions Act, 2008
Produce guidance on appropriate content of service level agreements in the form of a template	Pensions Board	Post-implementation via Social Welfare and Pensions Act, 2008
Continue to encourage service level agreements between trustees and third party service providers (other than administrators)	Pensions Board	Ongoing
Monitor the impact of new developments in relation to training and regulation on arrangements where the employer acts as sole trustee	Pensions Board	Ongoing
Include a provision in the Pensions Act to allow the Board to appoint a trustee, or authorise an administrator, to carry out wind-up procedures, where appropriate i.e. in situation where employer acting as a sole trustee goes into liquidation.	Pensions Board / DSFA	Social Welfare and Pensions Act, 2008
Keep under review statutory provisions to appoint trustees where none exist	Pensions Board	Ongoing
Amend Disclosure Regulations to replace existing provision that the trustee annual report contain a statement on access to training with a statement by the trustees on what training has actually and been arranged and received during each year	Pensions Board / DSFA	Post-implementation via Social Welfare and Pensions Act, 2008
Introduce legislation so that employers automatically arrange trustee training for all trustees within six months of their appointment and at least every two years thereafter	Pensions Board / DSFA	Social Welfare and Pensions Act, 2008

<b><u>ACTIONS</u></b>	<b><u>RESPONSIBILITY</u></b>	<b><u>TIMELINE</u></b>
Encourage trainers to hold regional training courses, including holding the Trustee Forum courses and seminars regionally from time to time and encourage trustees to train together, as far as practicable	Pensions Board / IAPF / trustee trainers	Ongoing
Explore potential of new means of trustee training delivery i.e. e learning	Pensions Board	2007
Continue to monitor the quality of trainers and training content including new content requirements e.g. ethical behaviour, service level agreements	Pensions Board	Ongoing
Amend Regulations to replace existing provision that the trustee annual report contain a statement on whether trustees have access to the Trustee Handbook to a compulsory requirement for each scheme to have a copy of the Handbook. Promote, as best practice, that all trustees of a scheme have a copy of the Handbook.	Pensions Board / DSFA	Post implementation via Social Welfare and Pensions Act, 2008
Promote, as best practice, that trustees should be supported financially in their role through the provision of compensation for expenses incurred and provided with adequate paid time off for trustee duties and trustee training, as appropriate	Pensions Board	Ongoing
Append "trustee checklist" to next edition of the Trustee Handbook to assist trustees in meeting their obligations	Pensions Board	When compiling next edition of Trustee Handbook
Guidance on trustee-employer relationships to be included in all trustee training	Pensions Board / trustee trainers	Ongoing
Member trustee Regulations review	Pensions Board/ DSFA	To be conducted as a separate project – timing to be agreed

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## **Appendix A – Pensions Board response to Law Reform Commission's proposals on trust law**

### **COPY**

Ms. Patricia Rickard-Clarke  
Solicitor  
Commissioner  
The Law Reform Commission  
35-39 Shelbourne Road  
Ballsbridge  
Dublin 4

27 April 2005

**Re: Consultation Paper on Trust Law General Proposals (LRC CP35-2005)**

Dear Ms. Rickard-Clarke,

The Pensions Board welcomes the Law Reform Commission's *Consultation Paper on Trust Law General Proposals (LRC CP35-2005)*. The Pensions Board's interest in this consultation document arises because it is responsible for supervising occupational pension schemes which are generally established as trusts. The Pensions Act, 1990 (as amended) ('the Act') imposes specific statutory obligations on trustees of pension schemes which can override general trust law. However, in the absence of a specific overriding provision the general provisions of trust law, the 1893 Act and the Trustee Authorised Investments Act, 1958 apply.

It should be noted that our comments on the Law Reform Commission's Consultation Paper are limited to those areas of trust law which are particularly relevant for pension schemes. Furthermore we have not considered those aspects of the Consultation Paper which deal with charitable trusts as such trusts are not within the remit of the Board.

The Consultation Document is particularly opportune from our point of view as many of the suggestions and recommendations therein touch on matters that have recently been (or continue to be) considered by the Department of Social and Family Affairs and the Pensions Board in deciding how to transpose Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision. This Directive puts in place minimum standards which are designed to ensure that occupational pension scheme transactions obtain a high level of security and efficiency and its provisions are required to be implemented by the Member States by 23 September 2005. The Government has implemented the provisions of the Directive requiring primary legislation in the Social Welfare and Pensions Act, 2005. Regulations will be drafted over the coming months to supplement this primary legislation, including trustee regulations (dealing with trustee qualifications and experience and good repute) and investment regulations (dealing with diversification and requirements to invest predominantly on regulated markets).

Our comments, by reference to the chapter headings in your consultation paper are as follows:-

### **Chapter 1**

Your attention is drawn to Section 34 of the Social Welfare and Pensions Act, 2005, which requires trustees to be of good repute and either have appropriate qualifications and experience to effectively run the pension scheme or to employ advisors with appropriate qualifications and experience to run it. Section 34 of the 2005 Act expressly prohibits certain individuals from acting as trustees. This section does not fully mirror your proposals, for instance we have not included a minor among the individuals prohibited from acting, although we would have no objection to such a step being taken as part of the reform of trust law generally. Our Member Trustee Regulations do require member trustees to be 18 years.

The Board also has the power to make a determination as to whether a trustee or person proposing to act as trustee satisfies the requirements of section 34, its determination can be appealed to the High Court within 21 days by the person affected. The section 34 provisions were introduced to comply with the requirements of Article 9.1(b) of Directive 2003/41 EC. Furthermore the Board has power to apply to the High Court under section 63 of the Pensions Act 1990 for the removal of trustees and under section 63A for the suspension of trustees in specified circumstances.

With regard to your recommendation that provisions along the lines of the English Trusts of Land and Appointment of Trustees Act 1996 be introduced in Ireland to facilitate the appointment by sui juris beneficiaries of trustees, we would suggest that for many trusts it may be practically impossible to identify all the sui juris beneficiaries. For instance in a pension scheme the range of potential beneficiaries may extend beyond the members to deferred members, spouses and dependants of members and deferred members and former spouse in respect of whom a pension adjustment order has been made.

### **Chapter 2**

The Board would agree with the Law Reform Commission's view that it is not appropriate to introduce a statutory default provision in relation to trustee remuneration.

The Board's reading of the Law Reform Commission's recommendation at para. 2.60 is that it is only intended to apply to charity trustees and the Board would suggest that this be clarified in the final report of the Commission by the insertion of the word "charity" before trustees.

### **Chapter 3**

We support the introduction of a statutory duty of care along the lines of the Trustee Act, 2000 (UK) as has been suggested by the Law Reform Commission. The Board notes the duty is to exercise such care and skill as is reasonable in the circumstances, having regard in particular (a) to any special knowledge or experience an individual trustee has or holds himself out as having, and (b) if the individual acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession. We would agree with the hybrid objective and subjective test proposed. Of course, where statutory obligations are imposed by the Pensions Acts rather than in general trust law the obligations are absolute and should not be qualified in any manner.

## **Chapter 4 – Investments**

The Law Reform Commission may be interested to note that in respect of pension schemes EU Directive 2003/41 embodies the prudent person principle approach to investment which is already a feature of UK and Irish trust law. It also requires inter alia that pension scheme assets be predominantly invested in regulated markets, be properly diversified, and their self investment be limited.

## **Chapter 5 – Power of sale, purchase and to issue receipt**

We do not propose to comment on this chapter.

## **Chapter 6 – Power to delegate**

Subject to the particular requirements of Directive 2003/41 as they apply to pension schemes, we support the Commission's proposal that legislation similar to Section 11 of the Trustee Act, 2000 (UK) be introduced to allow trustees delegate all of their functions other than –

- (a) any function relating to whether or in what way the assets of the trust should be distributed,*
- (b) any power to decide whether fees or other payment due to be made out of the trust funds should be made out of income or capital,*
- (c) any power to appoint a person to be a trustee of the trust, or*
- (d) any power conferred by any other enactment or the trust instrument which permits the trustees to delegate any of their functions are to appoint a person to act as a nominee or custodian.*

In respect of pension schemes, Directive 2003/41 imposes an obligation on trustees to delegate the running of the scheme to properly qualified advisers where the trustees do not have the appropriate qualifications and experience themselves to effectively run the pension scheme.

## **Chapter 7 – Liability of Trustees**

Our understanding of your proposal is that you are recommending the introduction of legislation to ensure that exemption clauses will not be capable of being relied on to exempt trustees from the "irreducible core obligations" of trusteeship e.g. fraud. It would be useful to fully set out the irreducible core obligations where you believe trustees should not be able to rely on the exemption clause in cases of failure to comply, in the final report.

We further note your suggestion that a statutory discretion similar to that in section 61 of the Trustee Act 1925 (UK) be introduced allowing a court to excuse a trustee from liability for breach of trust where he has acted honestly and reasonably, and ought fairly to be excused from breach of trust and for omitting to obtain the directions of the court in the matter in which he committed such breach, taking into account the hybrid statutory duty of care recommended. It is difficult to envisage whether this proposal will work well in practice or whether it will lead to a wide variance in decisions by the court.

Also the statutory ambit of the discretion would need to be carefully worded; so that there would be no question of it being raised by trustees in cases of criminal prosecutions e.g. prosecutions by the Board for breaches of the provisions of the Pensions Act.

## **Chapter 8, 9, 10 and 11**

We have no comments to make in respect of these chapters.

Finally, as a general observation, given the myriad of duties to which trustees are subject, has the Law Reform Commission given any consideration as to whether trustees should be obliged to undergo formal training concerning the nature of their duties and the standards expected of them?

We note that the Law Reform Commission will be making its final recommendations following further consideration of the issues. The Pensions Board would be obliged to receive a copy of the final document and would be happy to meet with the Commission to discuss the contents of this submission in more detail if required.

Yours sincerely,

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Sylvia McNeece

## **Appendix B – Existing supports to trustees (extract from Pensions Board’s 2005 Annual Report)**

Trustees have overall responsibility under the Pensions Acts for the administration of schemes. Accordingly, the main statutory functions of the Board, as set out in Section 10(1) of the Pensions Acts, include:

- providing guidance for trustees on their duties and responsibilities in relation to scheme administration,
- issuing codes of practice on specific aspects of trustees’ duties, and
- advising the Minister on standards for trustees and on their implementation.

The information booklet “So You’re a Pension Scheme Trustee?” gives concise guidance to trustees on their duties and responsibilities. An updated version of this booklet, to reflect legislative changes arising from the passing of the Pensions (Amendment) Act, 2002 and other legislation affecting pensions, was published in November 2005.

Comprehensive guidance is also provided for trustees by means of the Trustee Handbook and Codes of Practice which are designed to make a major contribution to the discharge of the Board’s functions under Section 10(1). The Trustee Handbook, which is in its second edition, is available by subscription from the Board. The Codes of Practice are available free of charge and are published online on [www.pensionsboard.ie](http://www.pensionsboard.ie).

Given the importance of the Handbook as a tool to assist the trustees in the effective discharge of their duties and responsibilities, the Disclosure of Information Regulations (S.I. 633 of 2005) contain a requirement that specific reference be made in the annual report of each scheme as to whether the trustees of the scheme have access to the Trustee Handbook.

The Board, which is represented on the Steering Group for the Trustee Forum of the Irish Association of Pension Funds, has contributed to the development of a Trustee Training Course which is run under the auspices of the Forum. The Board also continues to encourage the provision generally of appropriate training facilities for trustees of schemes and the take-up of these facilities by trustees.

The Board provides a specific enquiry service for trustees in relation to their duties and responsibilities, with particular reference to the type of information and guidance which is provided in the Trustee Handbook. Responses to some queries can only be provided by a scheme’s professional advisers, i.e. the actuary, auditor, investment manager or legal advisers, and guidance provided by the Board’s staff cannot be a substitute for specific professional advice in relation to a scheme.



## **Appendix C – Membership of Trusteeship Sub-Committee and the Pensions Board**

### Trusteeship Sub-Committee Members

Ms Yvonne White, (Chairperson), Pensions Board Executive  
Mr Kevin Brabazon, Pensions Board  
Ms Rosheen Callender, Pensions Board  
Ms Mary Hutch, Pensions Board Executive  
Mr Ciaran Lawler (on secondment from) Department of Social and Family Affairs  
Ms Sylvia McNeece, Pensions Board Executive  
Mr Jerry Moriarty, Pensions Board Executive  
Ms Cheryl Richardson, Pensions Board Executive  
Ms Mary Wade, Pensions Board

### Board Members

Mr Tiarnan O'Mahoney (Chairperson)  
Mr William Beausang  
Mr Kevin Brabazon  
Ms Rosalind Briggs  
Ms Rosheen Callender  
Mr Julian Caplin  
Ms Marie Daly  
Mr John Dillane  
Ms Mary O'Donnell  
Ms Emer O'Flanagan  
Mr Michael O'Halloran  
Mr Gerry Ryan  
Ms Dervla Tomlin  
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