

---

# **Stakeholder Pension Schemes**

## **A controls checklist**

**March 2002**

---

**PENSIONS RESEARCH ACCOUNTANTS GROUP**  
**STAKEHOLDER PENSION SCHEMES – A CONTROLS CHECKLIST**

**CONTENTS**

|   | Page |
|---|------|
| <b>INTRODUCTION</b>   | 4    |
| <br>  |      |
| <b>I EMPLOYER CONTROLS</b>  | 7    |
| Appendix I/A: Establishing and maintaining Stakeholder records  | 8    |
| Appendix I/B: Making sure the provider receives the correct information   | 13   |
| Appendix I/C: Making sure that the provider receives the information and Contributions within the given time limits                     | 15   |
| Appendix I/D: Changes to member details (permanent and temporary)   | 17   |
| Appendix I/E: Inland Revenue flowchart:<br>“Can I join a personal pension/stakeholder pension scheme?<br>If so, how much can I pay in?” | 19   |
| <br>  |      |
| <b>II ADMINISTRATION CONTROLS</b>   | 20   |
| Appendix II/A: Accepting new business   | 22   |
| Appendix II/B: Receiving contributions  | 26   |
| Appendix II/C: Changes to member details  | 34   |
| Appendix II/D: Timely production of benefit statements  | 37   |
| Appendix II/E: Benefits payable   | 40   |
| Appendix II/F: Service to members, employers and trustees   | 43   |
| Appendix II/G: Product features   | 45   |

---

## **CONTENTS (Continued)**

|  | Page      |
|--|-----------|
| <b>III INVESTMENT MANAGEMENT AND CUSTODY CONTROLS</b>          | <b>47</b> |
| Appendix III/A: General  | 50        |
| Appendix III/B: Investment objectives, policy and restrictions | 52        |
| Appendix III/C: Authorisation procedures                       | 55        |
| Appendix III/D: Transaction processing                         | 57        |
| Appendix III/E: Asset existence and recording                  | 65        |
| Appendix III/F: Income   | 66        |
| Appendix III/G: Expenditure and charges                        | 68        |
| Appendix III/H: Cash management                                | 69        |
| Appendix III/I: Unitised funds                                 | 71        |
| Appendix III/J: With-Profits funds                             | 74        |
| Appendix III/K: Compliance                                     | 75        |
| Appendix III/L: Security and contingency procedures            | 78        |
| Appendix III/M: Custodian administration                       | 80        |
| Appendix III/N: Sub-custodian network                          | 86        |
| Appendix III/O: Taxation                                       | 88        |
| Appendix III/P: Reporting by the custodian                     | 89        |

---

## Introduction

Stakeholder Pensions were launched in the United Kingdom on 6 April 2001. They represent a new era in private pension provision in this country and will have far-reaching consequences for the pensions industry in the coming years.

The objective of stakeholder schemes is to provide a low cost pension for those who have no access to occupational pension schemes or those who are unable to make provision for their retirement because they have no earnings of their own. Such schemes are defined contribution plans with “ear-marked” benefits for an individual – not dissimilar to the existing Group Personal Pension Plan arrangements.

### Purpose

The purpose of this document is to present an overview of the stakeholder pension environment and to identify examples of controls that should operate to reduce risk. As such, the document is designed to assist employers, stakeholder pension providers and others involved in the running of stakeholder pension schemes.

The document is divided into the following three chapters, which can be read in conjunction with one-another or separately.

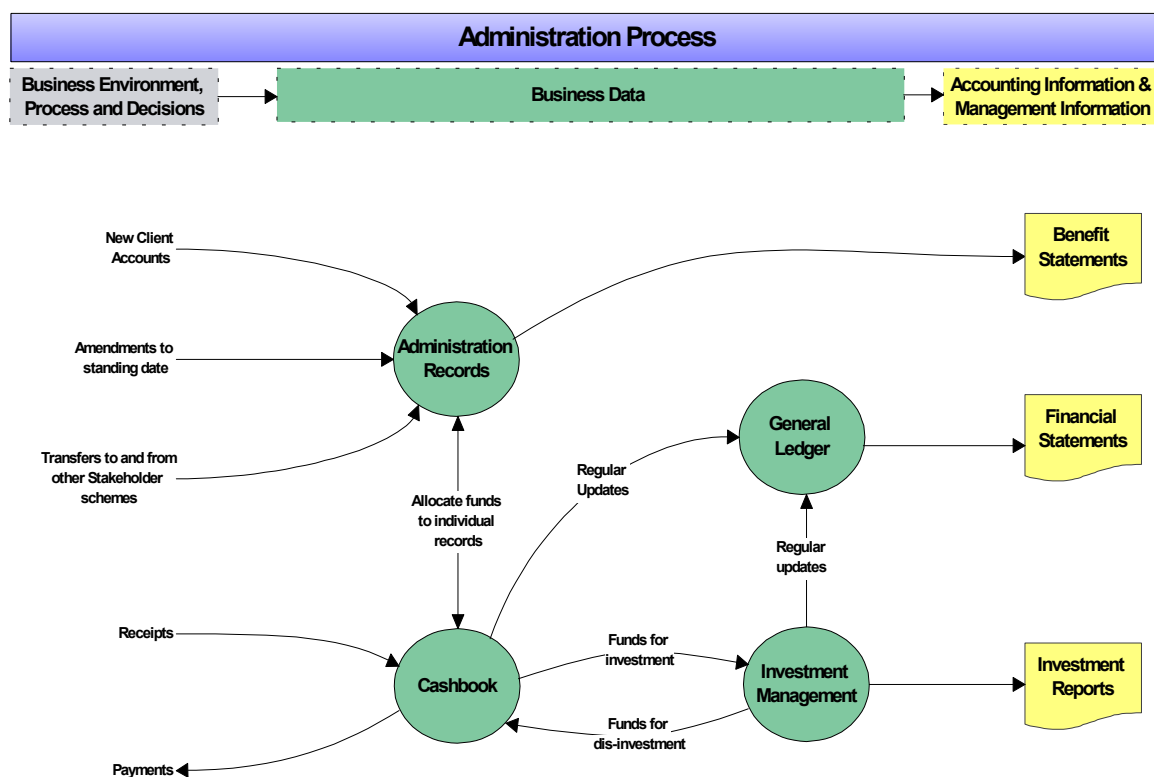
- I: Employer requirements;
- II: Scheme administration; and
- III: Investment Management and Custody.

The document is designed to be applicable to all stakeholder pension schemes and in order for this to remain an easy-to-read publication, there is generic separation of the role of the administrator, investment manager and custodian. It should be recognised, however, that the current stakeholder marketplace has blurred these traditional roles and much of this activity is now out-sourced to a number of specialist third party service organisations.

To this extent, reference should be made to the PRAG publication, *Outsourcing for Trustees*.

It is emphasised that, in preparing this controls checklist, the working party has developed a comprehensive list of possible controls. No stakeholder scheme will have all those listed. Stakeholder managers should seek to have an effective combination of controls to cover the risks for their scheme in an efficient and cost effective way.

A general overview of the interaction of all parties is detailed on the flowchart below.



## Legislation

The primary and secondary legislation is detailed below for reference purposes:

- Welfare Reform and Pensions Act 1999; and
- The Stakeholder Pension Schemes Regulations 2000 SI No 1403, as amended.

## Employer requirements

This section deals with the processes and controls once the employer has actually designated a stakeholder pension scheme and details the types of typical controls that could be expected to be in place over the maintenance of membership records and communication channels with the administrator.

The process that an employer is required to complete in order to designate a stakeholder schemes for his employees is **not** covered within this document.

Information about how to designate a stakeholder pension scheme is available on Opra's website at – [www.stakeholder.opra.gov.uk](http://www.stakeholder.opra.gov.uk) or by telephoning 01273 627 600.

---

The DWP has also published a number of guides for individuals, employers and providers on stakeholder pensions. The guides explain the different pension options available to individuals, information on the employer responsibilities for stakeholder pensions and an application form for prospective stakeholder providers. The guides can be found on [www.pensionguide.gov.uk](http://www.pensionguide.gov.uk) or by request on the following telephone numbers:

- Employer Orderline: 0845 7 646 646
- Stakeholder Helpline: 0845 601 2923

It should be noted however, that the designation of a stakeholder scheme for employees, (which was required by 8 October 2001), is not an overnight process and due care and attention should be applied when consulting with relevant employees.

### **Scheme administration**

Scheme administration provides the link between the employer and the investment management activities of a pension scheme and this activity is even more critical given the reporting and compliance requirements and cost restraints placed on stakeholder schemes.

It is important that the reader of this section, particularly if an employer, fully understands this process as this should result in a more efficient communication process being established. No matter how good the investment performance, a stakeholder scheme will rapidly lose its credibility in the eyes of its members if the administration is poor. Given that the interaction between the employer and administrator is the first source of identifying any compliance breaches, it is vital that the communication channel should be mutually understood.

### **Investment Management and Custody**

This section provides an overview of the investment management and custody process as well as detailing example controls that may be expected to operate.

Given the cost constraints built into the product, the current range of funds being offered by stakeholder schemes is considerable. With this background, the controls listed have been generic in nature rather than fund-specific. A degree of flexibility and adaptation is required when applying these in practice.

### **Publication**

This document has been prepared by a PRAG (Pensions Research Accountants' Group) working party. Any comments will be welcomed, and should be addressed to the working party chairman, Paul Brown c/o Deloitte & Touche, Stonecutter Court (SC4), 1 Stonecutter Street, London, EC4A 4TR.

Neither PRAG, nor members of any working party or committee thereof, can accept any responsibility or liability whatsoever (whether in respect of negligence or otherwise) to any pension scheme trustee or member or third party, wherever situate, as a result of anything contained or omitted from this publication nor for the consequences of reliance or otherwise on the content of this publication.

---

## I. EMPLOYER CONTROLS

### Introduction

Efficient and effective employer controls for stakeholder pension schemes are essential. Adequate systems and controls need to be in place in order to comply with the requirements for the details of information to be provided to the stakeholder manager and for the contributions to be passed to the provider within set time limits. Tough penalties can be imposed if these rules are breached; for example a fine of up to £50,000. This would clearly be very expensive for smaller employers. By far the best way to ensure compliance and to avoid regulatory problems is to have efficient and effective controls enforced in the first place.

### Employer controls

Once a Stakeholder scheme has been selected, obtaining an understanding of the employer's administration process should address:

- How staff requests are transferred to the payroll system
- How data input and changes are made
- How data and cash transfers occur.

### Stakeholder overview

This section does not address the issue of stakeholder access requirements or stakeholder selection. The Department of Work and Pensions, formerly known as the Department of Social Security, has issued a comprehensive guide on stakeholder access and designation on its website at [www.dss.gov.uk](http://www.dss.gov.uk). In addition, there is further information on the Opra website [www.stakeholder.opra.gov.uk](http://www.stakeholder.opra.gov.uk) which includes some very helpful questions and answers.

Decision trees for employee use are available on the website of the Financial Services Authority, [www.fsa.gov.uk](http://www.fsa.gov.uk), and there is a helpful DSS booklet "Stakeholder Pensions – Your Guide" number PM8, April 2001 version, which explains stakeholder schemes to potential members.

For an explanation of taxation, the Inland Revenue's booklet "Personal Pension Schemes (including Stakeholder Pension Schemes)", PSO2, published by the Inland Revenue's Savings, Pensions, Share Schemes section is available from the Inland Revenue. The website reference is [www.inlandrevenue.gov.uk](http://www.inlandrevenue.gov.uk). This booklet is aimed at members and includes two useful appendices, a decision tree for potential members on whether they can join and the potential level of contributions (reproduced as Appendix I/E to this checklist) and an illustration of contribution limits.

### Identify and source risks

Having consulted with the workforce and selected a stakeholder provider, the employer should identify and address the inherent information and information processing risks. This is a judgemental process that is supported by considering the presence of potential risk indicators and evaluating what can go wrong in each component of the process. We have considered the following processes:-

- Appendix I/A: Informing staff and collecting membership forms and data
- Appendix I/B: Making sure that the provider receives the correct information
- Appendix I/C: Making sure that the provider receives the information and contributions within the given time limits
- Appendix I/D: Changing personal details permanently and temporarily (eg. sickness, maternity leave etc.)

Note that investment choices are between the member and the provider, and are not the responsibility of the employer.

## Identification of controls

The following section looks at each stage of the administration process and provides an overview of the key processes identified above and possible controls.

### 1 Possible controls over establishing and maintaining Stakeholder records

| POSSIBLE CONTROLS |   | Good = ✓<br>Weak = X | COMMENTS |
|-------------------|---|----------------------|----------|
| 1.1               | All eligible employees within three months of joining the employer have received appropriate information about the scheme and an application form and scheme details. A signed receipt has been received stating <b>whether or not</b> they wish to join the scheme.                                  |                      |          |
| 1.2               | All birth dates and NI numbers are submitted and verified on the initial joining documents ie checked to the source documentation.  |                      |          |
| 1.3               | Copies of the signed membership forms are kept separately on HR files as backup (negative forms should also be kept).<br>If applications are processed (by the provider) over the website or by telephone (where no signature is required) confirmation of membership should be filed on the HR file. |                      |          |
| 1.4               | Contribution levels are established and written and signed copies of this are kept on personal HR files.  |                      |          |
| 1.5               | Requests to alter contribution amounts are actioned by the end of the pay period following the pay period in which the request is made, or actioned in the appropriate period if the request relates to a later period.   |                      |          |

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = X | COMMENTS |
|-------------------|--|----------------------|----------|
|                   | Note: An employee cannot request more than one change every six months – unless the employer agrees to more frequent changes; the employee can ask for payroll deductions to stop at any time.   |                      |          |
| 1.6               | When an employee joins the designated stakeholder pension scheme (or when the information about the scheme is first given to the employee), the employer explains the process and rules for employees requesting a change to the amount they contribute.   |                      |          |
| 1.7               | Providers need not accept contributions of less than £20 if they have written this condition into the stakeholder pension scheme rules. It is suggested that employers may wish to check if this condition has been written into the designated scheme's rules and communicate this information to employee when information about the designated scheme is first given to the employee. |                      |          |
| 1.8               | Members and their NI data are identified.  |                      |          |
| 1.9               | Staff dealing with the stakeholder pension scheme administration are fully trained and competent – in accordance with FSA rules.   |                      |          |

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|--|----------------------|----------|
| 1.10              | If a key member of the stakeholder pensions administration staff is away, there are adequate, trained back up staff to complete the job. |                      |          |
| 1.11              | There is a disaster recovery plan for the records.   |                      |          |
| 1.12              | The provider's disaster recovery plan is adequate for the employer's purposes.   |                      |          |
| 1.13              | Payslips show contributions paid to the provider   |                      |          |
| 1.14              | Payroll is set up to make deductions from <b>net pay</b> of employees and to calculate employer contribution where relevant.             |                      |          |
| 1.15              | There are controls over payroll to ensure that tax limits on contributions are not breached.   |                      |          |
| 1.16              | The payroll can produce P60 forms to reflect the introduction of the stakeholder scheme.   |                      |          |

| <b>POSSIBLE CONTROLS</b> |  | <b>Good = ✓<br/>Weak = ✗</b> | <b>COMMENTS</b> |
|--------------------------|--|------------------------------|-----------------|
| 1.17                     | Standard forms are used when making changes to standing data. (eg new member forms, revised contribution request, etc) and such forms are authorised by employer and employee.   |                              |                 |
| 1.18                     | Each member has signed a form stating an alternative arrangement should their wages fall to below a stated level (eg maternity leave and statutory sickness) and above a certain level (eg when bonus payments are made). This information is to be given to the payroll department. |                              |                 |
| 1.19                     | Attention is paid to changes in members' contributions with respect to gross pay/basic pay.  |                              |                 |
| 1.20                     | Access violation attempts and violations to the payroll and master files are investigated and resolved.  |                              |                 |
| 1.21                     | Unusual items and balances on the administration system, for example duplicate NI numbers, are shown on an exception report and reviewed on a regular basis.   |                              |                 |

---

| <b>POSSIBLE CONTROLS</b> |  | <b>Good = ✓<br/>Weak = ✗</b> | <b>COMMENTS</b> |
|--------------------------|--|------------------------------|-----------------|
| 1.22                     | There is password protection so that only members and/or staff can make amendments to administration records.      |                              |                 |
| 1.23                     | Exception reports are sequentially numbered. Any missing reports are investigated and resolved in a timely manner. |                              |                 |
| 1.24                     | From time to time, the internal audit function reviews the controls surrounding changes to member details.         |                              |                 |

## 2 Making sure that the provider receives the correct information

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|--|----------------------|----------|
| 2.1               | There is a clear written agreement with the provider on the direct pay arrangement and data requirements. That agreement should include a date by which employer contributions (if payable) are to be paid to the provider. Ideally this date should coincide with the payment of employee contributions (the latest payment date in respect of employee contributions is 19 <sup>th</sup> of the month following the deduction of those contributions from pay. |                      |          |
| 2.2               | There is a mechanism to ensure that data on joiners and leavers (including maternity leave and deaths) are promptly notified to payroll and to the stakeholder provider.<br>There is a mechanism to ensure that the record of contributions relating to the monthly payment is updated accordingly and sent to the provider so that it is received on or before the payment date.  |                      |          |
| 2.3               | <b>Every month</b> , standing member data is reconciled with standing payroll data and with the provider's statement. (eg brought forward (contributions + membership numbers) from previous payroll period +/- changes (contribution changes and membership movements = carried forward (contributions + membership numbers) to next pay period).   |                      |          |
| 2.4               | Any discrepancies in the reconciliation above are investigated and resolved on a timely basis, and signed off by a manager.  |                      |          |

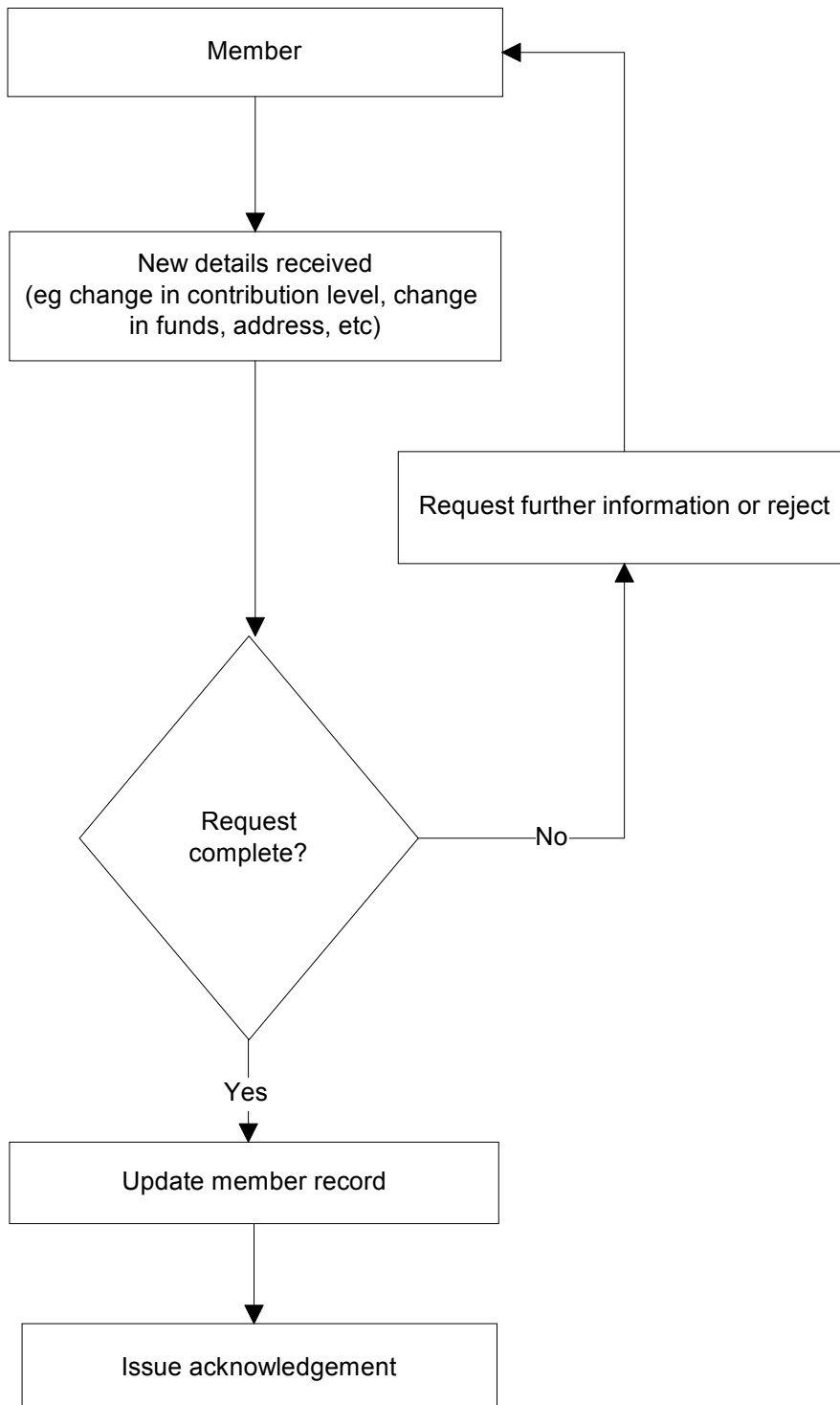
| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|--|----------------------|----------|
| 2.5               | Having prepared a record of payments due, the data is reconciled to the employer's membership database.  |                      |          |
| 2.6               | Deductions made by payroll are reconciled with the record of payments due.   |                      |          |
| 2.7               | Monthly receipts/statements from the stakeholder provider are reconciled to payroll totals. Discrepancies are checked and rectified.   |                      |          |
| 2.8               | Providing there is comfort over the correctness of payroll, reconciliations should be done between members present on the payroll and payment of contributions from the employer to the provider on behalf of these members.           |                      |          |
| 2.9               | If a contribution is being paid to the provider without the corresponding member being on the payroll (ie a discrepancy in the above reconciliation) this should be resolved as a matter of urgency and reported to senior management. |                      |          |
| 2.10              | The provider should be notified in writing immediately of any deaths and a record of their acknowledgement should be kept on central file at the employer.   |                      |          |

### 3 Making sure that the provider receives the information and contributions within the given time limits

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = X | COMMENTS |
|-------------------|--|----------------------|----------|
| 3.1               | <p>The agreed timetable for the transmission of the record of payments due to the provider is realistic and there is sufficient time to rectify errors and underpayments before the 19<sup>th</sup> of the month following that in which the relevant contributions were deducted (see 2.6 above).</p> <p>The timetable for payments also allows enough time for bank and staff holidays.</p> <p>Special attention should be taken if a weekly payroll is run. These run a greater risk not paying the correct amount of contributions over to the provider within the deadline.</p> |                      |          |
| 3.2               | There is a proper contingency plan should any system failure occur.  |                      |          |
| 3.3               | The staff dealing with the payments are fully competent (with reference to FSA rules) and understand the legal requirements for timely payment.  |                      |          |
| 3.4               | Staff responsibilities at the employer for passing the record (whether paper form or electronically) to the provider are clear and unambiguous, with proper back-up arrangements for staff absences.   |                      |          |
| 3.5               | The employer's contributions are added to the record of payments due, where relevant, and there is an independent check to ensure that this is correct.  |                      |          |

| POSSIBLE CONTROLS |   | Good = ✓<br>Weak = X | COMMENTS |
|-------------------|---|----------------------|----------|
| 3.6               | The payments made to the provider are authorised and the person authorised and responsible for transmission of the contributions (whether electronically or by cheque) understands the importance of the time rule. |                      |          |
| 3.7               | Unusual items and balances eg sums deducted in excess of net pay are shown on exception reports and followed up.  |                      |          |

#### 4 Changes to member details (permanent and temporary)

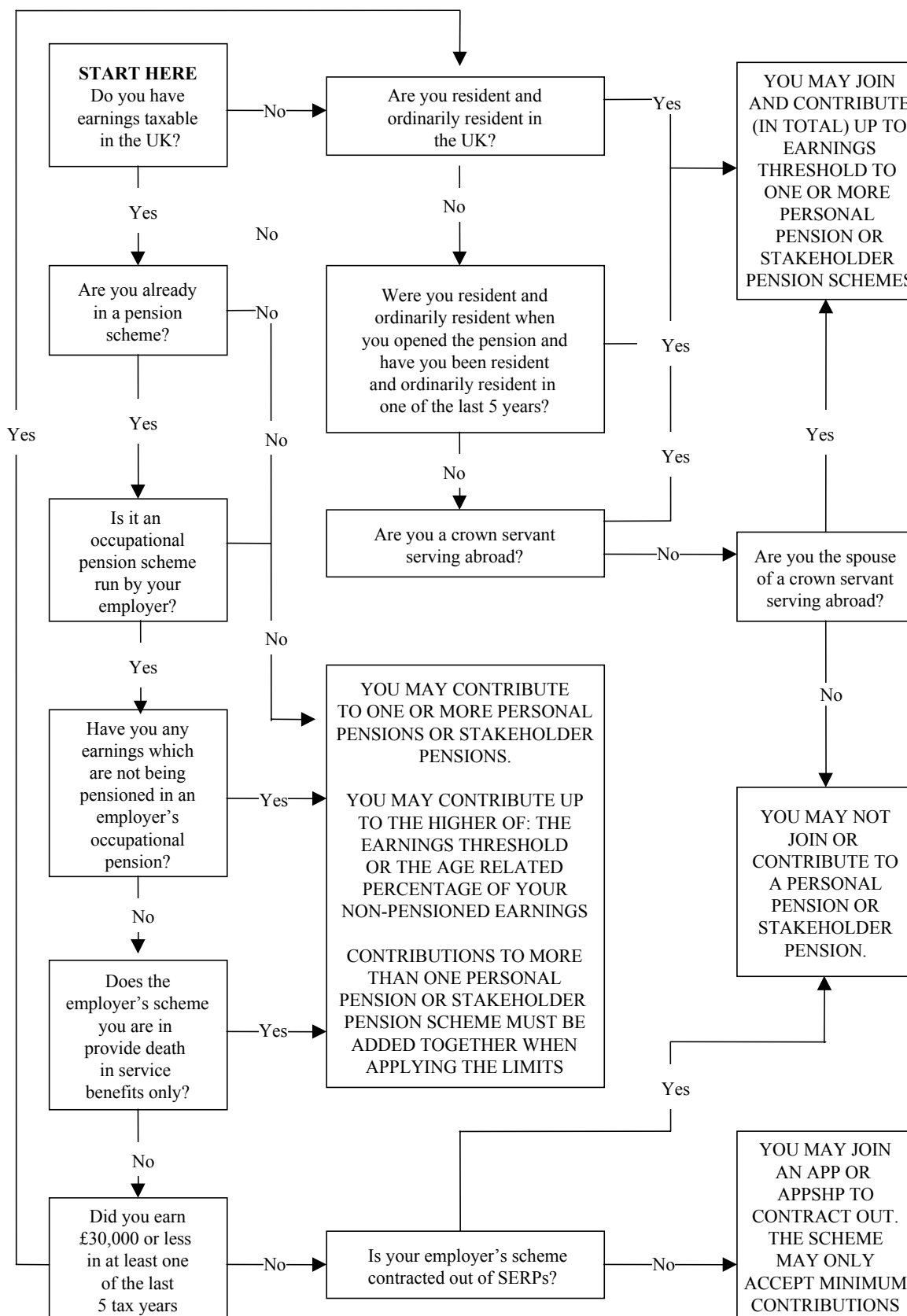


| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = X | COMMENTS |
|-------------------|--|----------------------|----------|
| 4.1               | Standard forms are used when making changes to standing data. (eg new member forms, revised contribution request, etc) and such forms are authorised by employer and employee. |                      |          |
| 4.2               | Access violation attempts and violations to the payroll and master files are investigated and resolved.  |                      |          |
| 4.3               | Unusual items and balances on the administration system, for example duplicate NI numbers, are shown on an exception report and reviewed on a regular basis.                   |                      |          |
| 4.4               | There is password protection so that that only members and/or staff can make amendments to administration records.   |                      |          |
| 4.5               | Exception reports are sequentially numbered. Any missing reports are investigated and resolved in a timely manner.   |                      |          |
| 4.6               | From time to time, the internal audit function review the controls surrounding changes to member details   |                      |          |

(Source: Inland Revenue)

Can I join a personal pension/stakeholder pension scheme? If so, how much can I pay in?

Note – this flowchart does not apply to controlling directors, people over age 75, or people contributing above the earnings threshold who stop being UK residents.



## II. ADMINISTRATION CONTROLS

### Introduction

Efficient and effective administration of a stakeholder pension scheme is essential. Adequate systems and controls need to be in place in order to comply with the minimum conditions on cost, access and flexibility. The provider will be dealing with thousands of receipts from different sources, ie BACS payments, members' cheques, cash and payments made over the internet. If the provider fails to receive contributions sent by an employer before the statutory deadline they have a duty to report this to Opra. The contributions need to be invested in accordance with the members' wishes in a timely fashion and recorded on the administration system.

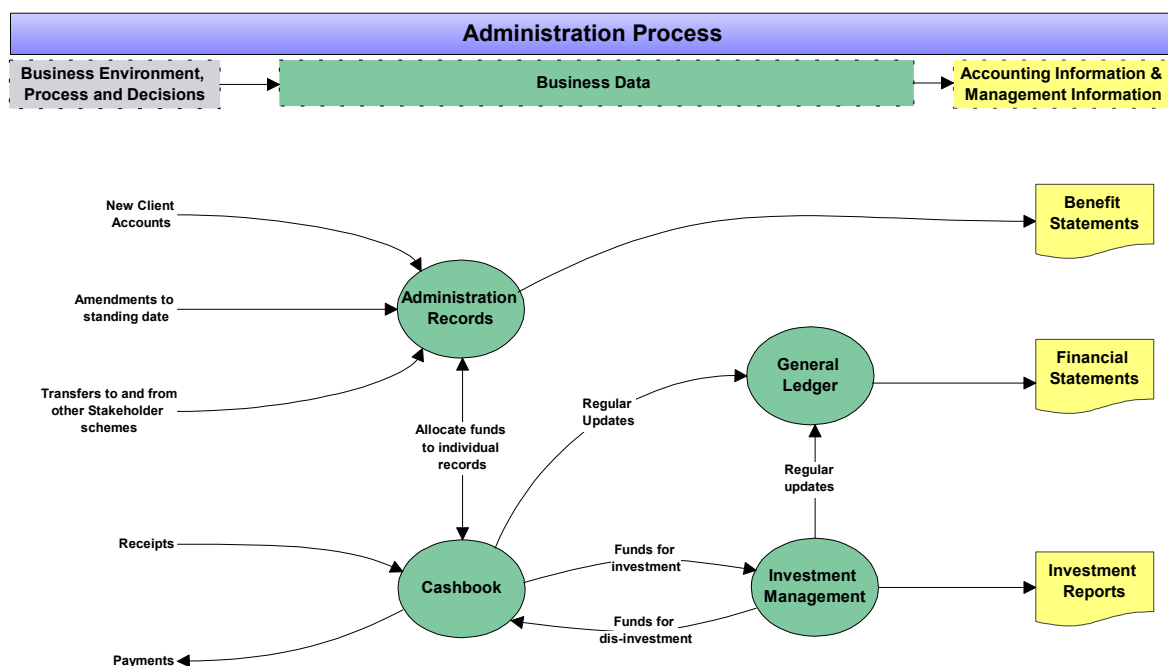
### Pension scheme administration

Obtaining an understanding of the administration process should address:

- How are business transactions, events and facts are transferred to the administration system?
- What services are offered to employers, individuals and trustees?
- What are the product features?
- How is data input and changes made?
- How do data transfers occur?
- What are the conversion/processing processes?
- What journal entries are made?
- What is the output from this process?

### Stakeholder overview

The diagram overleaf provides an overview of the information flows of a stakeholder pension scheme. The investment manager and administrator may be part of the same organisation. However, it is possible that the investment manager and scheme administrator could be separate entities who have decided to operate a stakeholder scheme.



---

## Identify and source risks

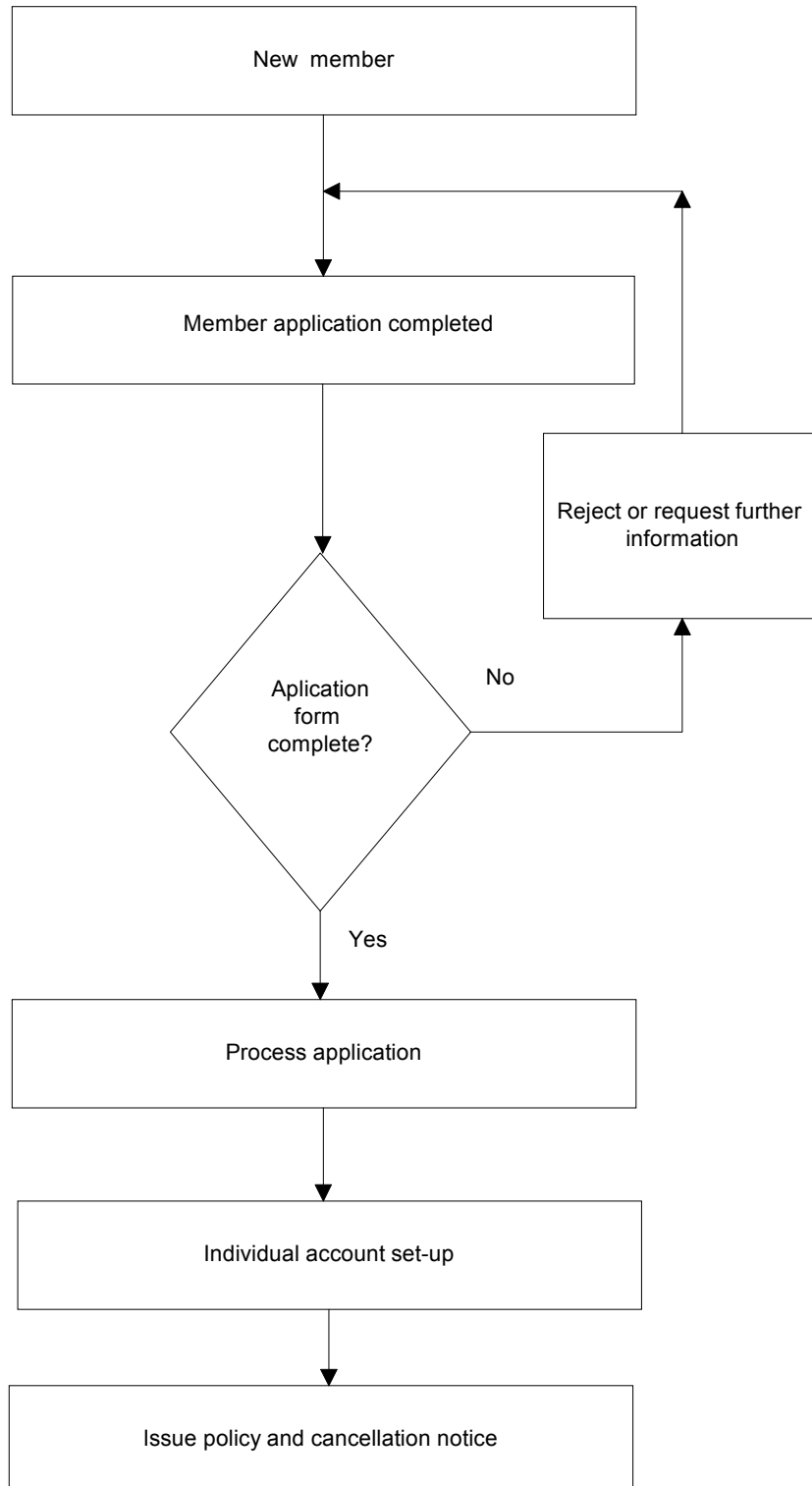
After establishing how the scheme operates, the interested party should identify and source the inherent information and information processing risks. This is a judgemental process that is supported by considering the presence of potential risk indicators and evaluating what can go wrong in each component of the process. We have considered the following processes:-

|                |  |
|----------------|--|
| Appendix II/A  | Accepting new business                     |
| Appendix II/B: | Receiving contributions                    |
| Appendix II/C: | Changes to member details                  |
| Appendix II/D: | Paying benefits                            |
| Appendix II/E: | Timely production of benefit statements    |
| Appendix II/F: | Service to members, employers and trustees |
| Appendix II/G: | Product features                           |

---

## Accepting new business

### Overview



### Possible controls over accepting new business

The provider will need to have controls in place to make sure that:

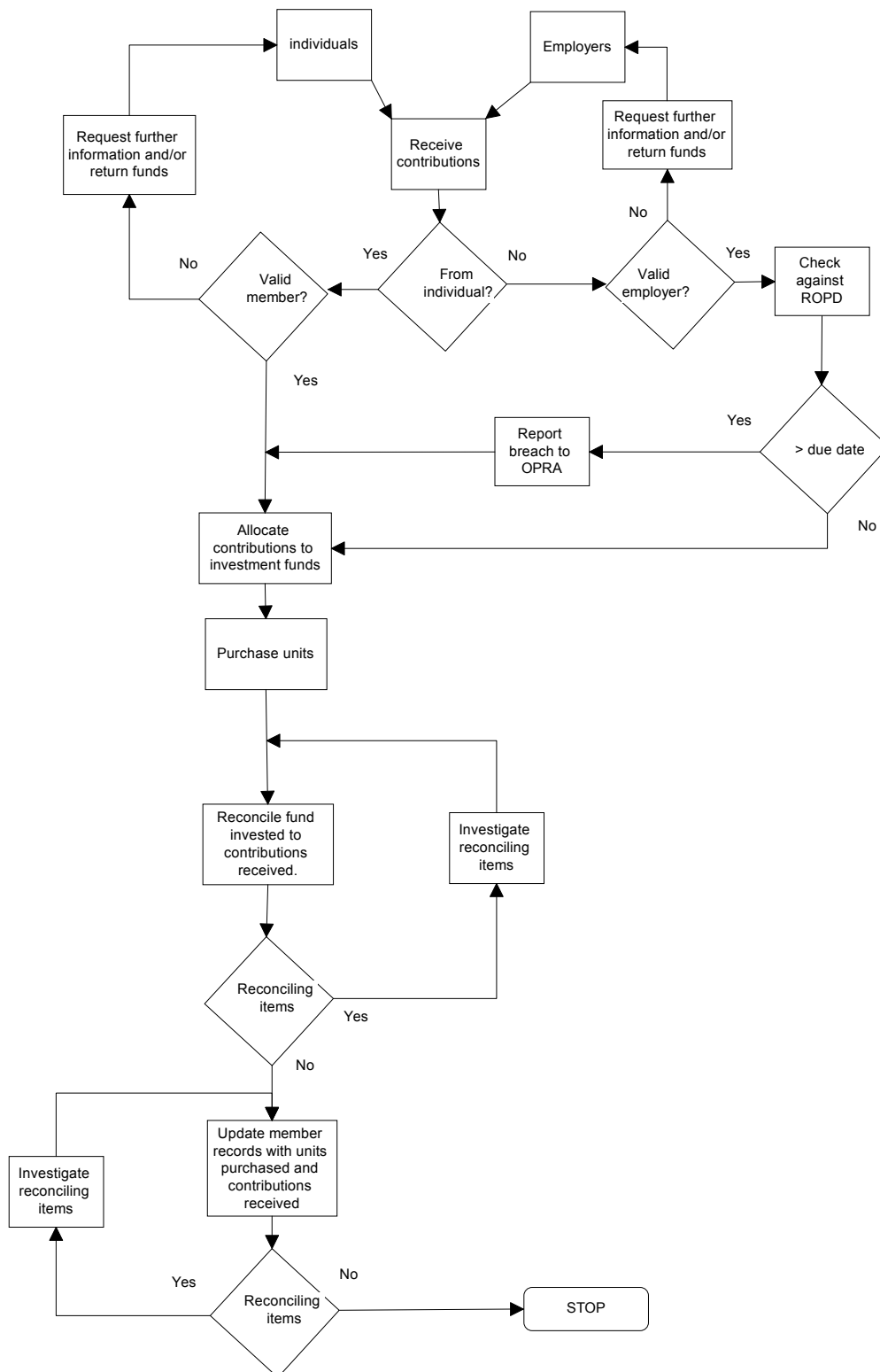
- a compliant sale has been made;
- applicants have been taken through decision trees where necessary;
- the relevant application forms and declarations have been made by the applicant, or that the applicant has empowered the provider to make the declaration and the provider has made it and issued it;
- the appropriate documents are issued to the appropriate places e.g. correct policy documents to the customer, direct debit mandates to bank etc;
- details of when employers pay employees are captured where there are to be direct payment arrangements;
- cancellation notices are issued;
- returned cancellation notices are logged in when received and completed ones are logged out; and
- action is taken on cancellation notices.

| POSSIBLE CONTROLS |   | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|---|----------------------|----------|
| 1.1               | New member forms are checked before being input onto the system.  |                      |          |
| 1.2               | The new member program assigns a number to new members entered. All new members are accounted for to explain breaks in the numerical sequencing and to ensure that new members are entered on a timely basis. |                      |          |

| POSSIBLE CONTROLS |   | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|---|----------------------|----------|
| 1.3               | New member applications are time and date stamped and entered onto the administration system to ensure that new members are captured and input in a timely fashion. The date and time stamping ensures that operational performance standards are in accordance with management's expectations. |                      |          |
| 1.4               | Record counts are used to ensure new members are complete and processed promptly. Record counts of actual new members are compared to the new members file. Exceptions are investigated and resolved in a timely manner.  |                      |          |
| 1.5               | Transmission checks are used to ensure that member information (eg member name, NI number) obtained from the applicable master file is properly reflected in the administration program.  |                      |          |
| 1.6               | Standard forms are used and reviewed on a regular basis to ensure all relevant information is provided to the administrator. For example, support for contribution payments, new member applications, etc.  |                      |          |
| 1.7               | Validity checks ensure that NI numbers are entered in the correct format.   |                      |          |

| POSSIBLE CONTROLS |   | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|---|----------------------|----------|
| 1.8               | Prior to data input, the scheme administrator compares the member's name to their client list.                            |                      |          |
| 1.9               | Access violation attempts and violations to the administration program and master files are investigated and resolved.    |                      |          |
| 1.10              | Unusual items and balances on the administration system are shown on an exception report and reviewed on a regular basis. |                      |          |
| 1.11              | Password protection ensures that authorised staff can only make amendments to administration records.                     |                      |          |
| 1.12              | Exception reports are sequentially numbered. Any missing reports are investigated and resolved in a timely manner.        |                      |          |
| 1.13              | Performance monitoring reports are produced promptly in an easily understood form, with only key data being highlighted.  |                      |          |

2 Receiving contributions



---

## Possible controls over receiving contributions

Money may be received from the member, a member's employer, as a transfer value from another pension scheme (stakeholder or otherwise) a pension credit from another pension scheme, contracted-out rebates, tax relief on member contributions from the Inland Revenue and payments from a third party.

Where there is a direct payment arrangement the trustee/manager has duties to report late payment to Opra and members. There also needs to be a record of the direct payment arrangement, referred to as the record of payments due.

Schemes must accept all payments made by direct debit, direct credit, cheque and standing order. Additionally schemes can accept money by other means if they so desire. This means one scheme may accept payments from a variety of different sources. Each provider is likely to have different processes and each will need to be looked at to ensure all money received is correctly allocated to the right member and invested in the right funds.

The Inland Revenue limit the amount that can be paid to policies and schemes will need to have controls in place to police this and deal with any excessive amounts received. Individual members have to undertake to make sure that they do not make contributions in excess of Inland Revenue limits. The scheme manager/trustees need to ensure that members know of all payments received from third parties, which will count towards the member's limit.

Schemes will need to have in place processes to promptly claim tax relief from the Inland Revenue, and invest this on receipt.

Schemes will need to have processes/controls in place to:

- collect money from accounts on the appropriate dates agreed with the member
- claim appropriate amounts of tax relief for member contributions
- identify bounced debits and cheques to ensure all are actioned
- allocate all money received to each member's account appropriately and invest in the appropriate funds
- control cheques received and ensure allocated to correct member's plan
- check bulk payments e.g. from employers to ensure the total received corresponds with total amounts shown on the record of payments due for each member and to follow up discrepancies
- identify any payments for people who are not members of the scheme, or members for whom there is an expectation of a payment, but no payment and take action to resolve
- report late payments to Opra and members as appropriate
- identify when a record of payments due should be received and none is
- report instances where no record of payments due is received to Opra
- ensure all late payments are reported to Opra and members
- ensure that data about when an employer pays employees is kept up to date to ensure contribution controls can be applied correctly

- check the maximum permissible contribution for a member and limit contributions to this
- identify if the contribution is more than 25% more than the highest previous contribution for the member and if so issue cancellation rights
- refund any contributions received which are in excess of the maximum allowed for a member
- ensure no tax relief is claimed for contributions which are refunded
- ensure refunds of excessive contributions are made to the correct person
- notify the member of all payments received from third parties
- ensure that payments cannot be received from third parties which are not notified to the member
- ensure claims for basic rate tax relief are made accurately and promptly
- ensure that once tax relief is received from the Inland Revenue, it is credited to the appropriate members promptly, or promptly invested (where investment has been net of tax relief)
- controls exist to identify any errors, warnings, or payments which are rejected and that processes are in place to deal with these lists and that audit trails exist to demonstrate they have been actioned
- missing reports can be identified and processes exist to trace any 'lost' reports
- checks are made to ensure that the money received each day corresponds to the value of investments bought for that day.

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = X | COMMENTS |
|-------------------|--|----------------------|----------|
| 2.1               | Contributions are stamped with a unique number on receipt.   |                      |          |
| 2.2               | Contributions are stamped with the date and time when received.  |                      |          |
| 2.3               | Contributions are paid over by credit transfer on an agreed date.  |                      |          |
| 2.4               | Contributions submitted by employer are monitored against the Record of Payments Due and late or missed payments are reported to management, [the trustees] and Opra.                                      |                      |          |
| 2.5               | There are regular bank reconciliations to ensure all contributions are banked accurately, completely and in a timely fashion   |                      |          |
| 2.6               | Internal audit review the procedures surrounding the timely capture of contributions   |                      |          |
| 2.7               | Contributions are only accepted if supported with a standard form which details the members' contributions and, in the case where there is a sponsoring employer, any changes since the previous month.    |                      |          |
| 2.8               | Standard forms are used and reviewed on a regular basis to ensure all relevant information is provided to the administrator. For example, support for contribution payments, new member applications, etc. |                      |          |

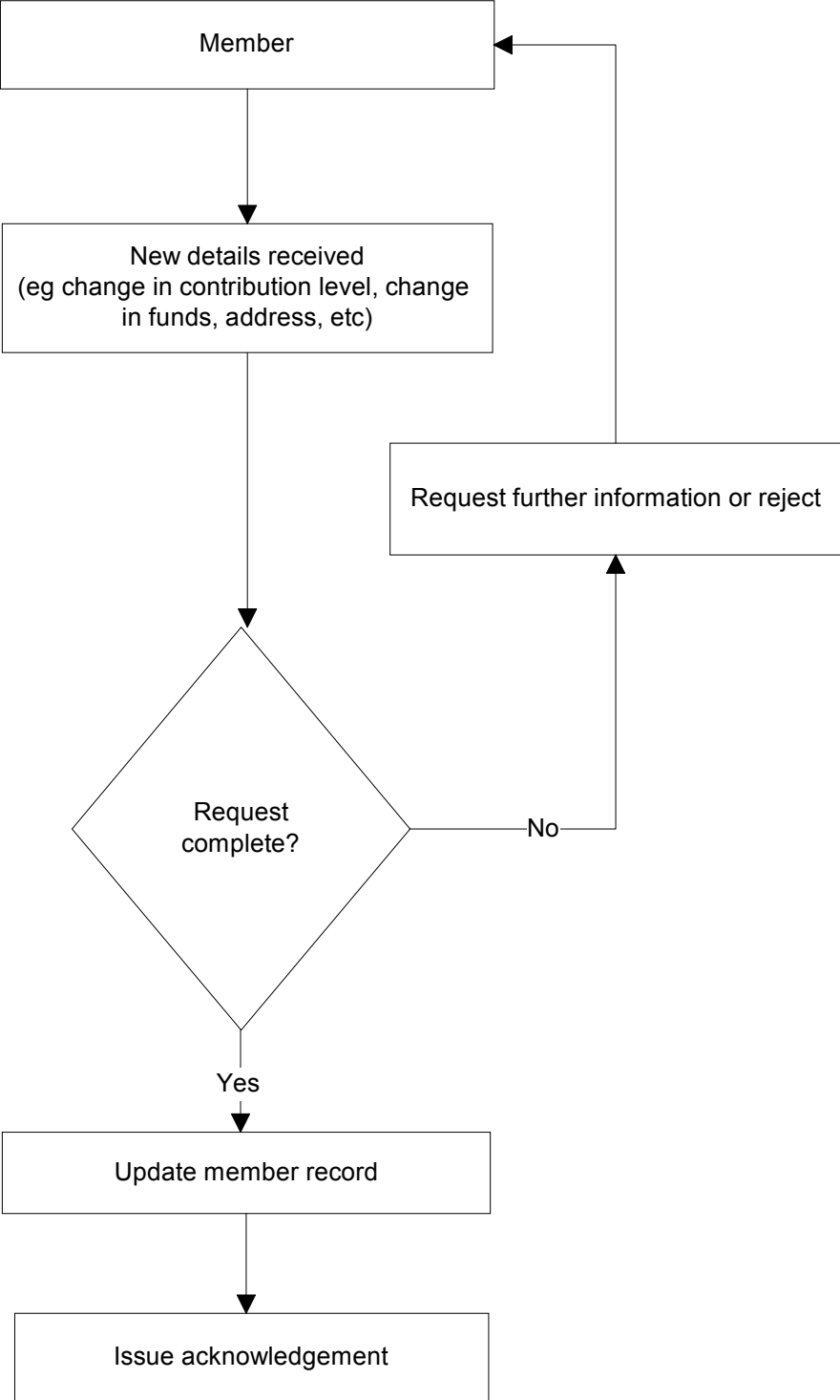
| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|--|----------------------|----------|
| 2.9               | Contributions are analysed by member and agreed to the contributions received before being banked.   |                      |          |
| 2.10              | The administration system compares the units purchased to the units allocated on the member records to ensure that the unit allocation is complete.  |                      |          |
| 2.11              | Automated checks ensure that a member's contributions do not exceed statutory limits. An exception report highlights any anomalies, which are investigated and resolved in a timely fashion. |                      |          |
| 2.12              | Where the administrator has access to the employer's payroll records, these are regularly reconciled to contributions paid over.   |                      |          |
| 2.13              | Contributions are only banked if they are from registered clients  |                      |          |
| 2.14              | Where the employer has direct access to the stakeholder records these can only be updated after inserting a password.  |                      |          |
| 2.15              | Prior to data input, the scheme administrator compares the member's reference number to their client list.   |                      |          |
| 2.16              | The amount received is reconciled to the amount entered on the administration system and any differences investigated.   |                      |          |

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|--|----------------------|----------|
| 2.17              | Any contributions, which have not been allocated, are posted to a suspense file and a report is generated and periodically reviewed to ensure that all processing is occurring for all properly authorised transactions or that the transaction has been cancelled if appropriate. |                      |          |
| 2.18              | Member allocations on the administration system are agreed to member allocations from companies and individuals.   |                      |          |
| 2.19              | Batch totals are used to record daily total contributions received to ensure the completeness, accuracy and timeliness of data input. Exceptions are investigated and resolved.  |                      |          |
| 2.20              | Cash receipts and payments are agreed to the investment managers' records.   |                      |          |
| 2.21              | The unit holdings and values shown on the administration system are compared to the investments held by the investment manager. Any differences are investigated and resolved on a regular basis.  |                      |          |
| 2.22              | Investment allocations are approved by the member.   |                      |          |
| 2.23              | An exception report is generated when the cash invested does not agree to the contributions allocated on the members' file. Reconciling items are investigated and resolved in a timely fashion.   |                      |          |

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|--|----------------------|----------|
| 2.24              | A standard screen format is used for on-line entry of journal entries to ensure accuracy of information.   |                      |          |
| 2.25              | Access violation attempts and violations to the administration program and master files are investigated and resolved.   |                      |          |
| 2.26              | Unusual items and balances on the administration system are shown on an exception report and reviewed on a regular basis.  |                      |          |
| 2.27              | Journal entries are sequentially numbered and reviewed by a senior member of staff. Any missing journals are investigated and resolved in a timely manner.           |                      |          |
| 2.28              | Exception reports are sequentially numbered. Any missing reports are investigated and resolved in a timely manner.   |                      |          |
| 2.29              | Password protection ensures that authorised staff can only make amendments to administration records.  |                      |          |
| 2.30              | Units allocated to membership records in excess of a set amount are reported to management. Management investigates and resolves these exceptions on a timely basis. |                      |          |
| 2.31              | Contribution records are reconciled on a regular basis to unit and/or other allocation reports provided by the investment manager and any discrepancies resolved.    |                      |          |

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|--|----------------------|----------|
| 2.32              | <p>Reports consolidate all aspects of the administration function:</p> <ul style="list-style-type: none"> <li>- membership statistics</li> <li>- contributions by member</li> <li>- investments by member</li> <li>- benefit statements</li> </ul> |                      |          |
| 2.33              | <p>Performance monitoring reports are produced promptly in an easily understood form, with only key data being highlighted.</p>  |                      |          |

3 Changes to member details



**Possible controls over changes to member details**

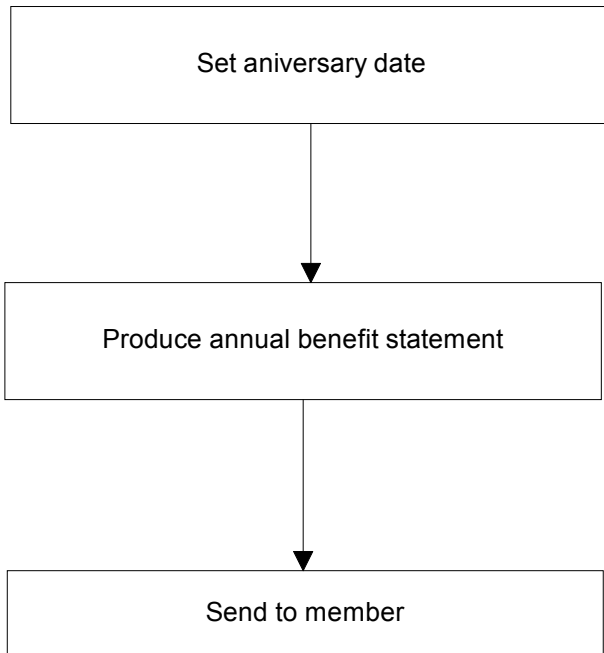
This covers a wide range of work and the administrator should ensure that:

- there are processes in place to manage work coming in and ensure that it is processed and completed in a timely manner
- if members can directly access scheme records, that adequate and suitable controls are in place to ensure that people only have access to the records they are entitled to
- processes are in place to verify that requests for personal information are from people who are entitled to have the information
- there are controls in place to verify that information being provided is accurate whether produced by computer systems or manually
- Any error and warning reports produced are dealt with and an audit trail exists to demonstrate this.
- Processes and controls are in place to make sure that all expected error and warning reports are received and any 'missing' ones are obtained.

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = X | COMMENTS |
|-------------------|--|----------------------|----------|
| 3.1               | Standard forms are used when making changes to standing data. (eg investment choices, transfers, etc)  |                      |          |
| 3.2               | Access violation attempts and violations to the administration program and master files are investigated and resolved.                                       |                      |          |
| 3.3               | Unusual items and balances on the administration system are shown on an exception report and reviewed on a regular basis, for example, duplicate NI numbers. |                      |          |
| 3.4               | Password protection ensures that only members and/or staff can make amendments to administration records.  |                      |          |
| 3.5               | Exception reports are sequentially numbered. Any missing reports are investigated and resolved in a timely manner.   |                      |          |
| 3.6               | Performance monitoring reports are produced promptly in an easily understood form, with only key data being highlighted.                                     |                      |          |
| 3.7               | Member's wishes are acted upon in accordance with the Regulations.   |                      |          |
| 3.8               | From time to time, the internal audit function review the controls surrounding changes to member details   |                      |          |

---

**4 Timely production of benefit statements**



### Possible controls over the timely production of benefit statements

The regulations require that all members receive a benefit statement every year and that the statement is provided within 3 months of the relevant date.

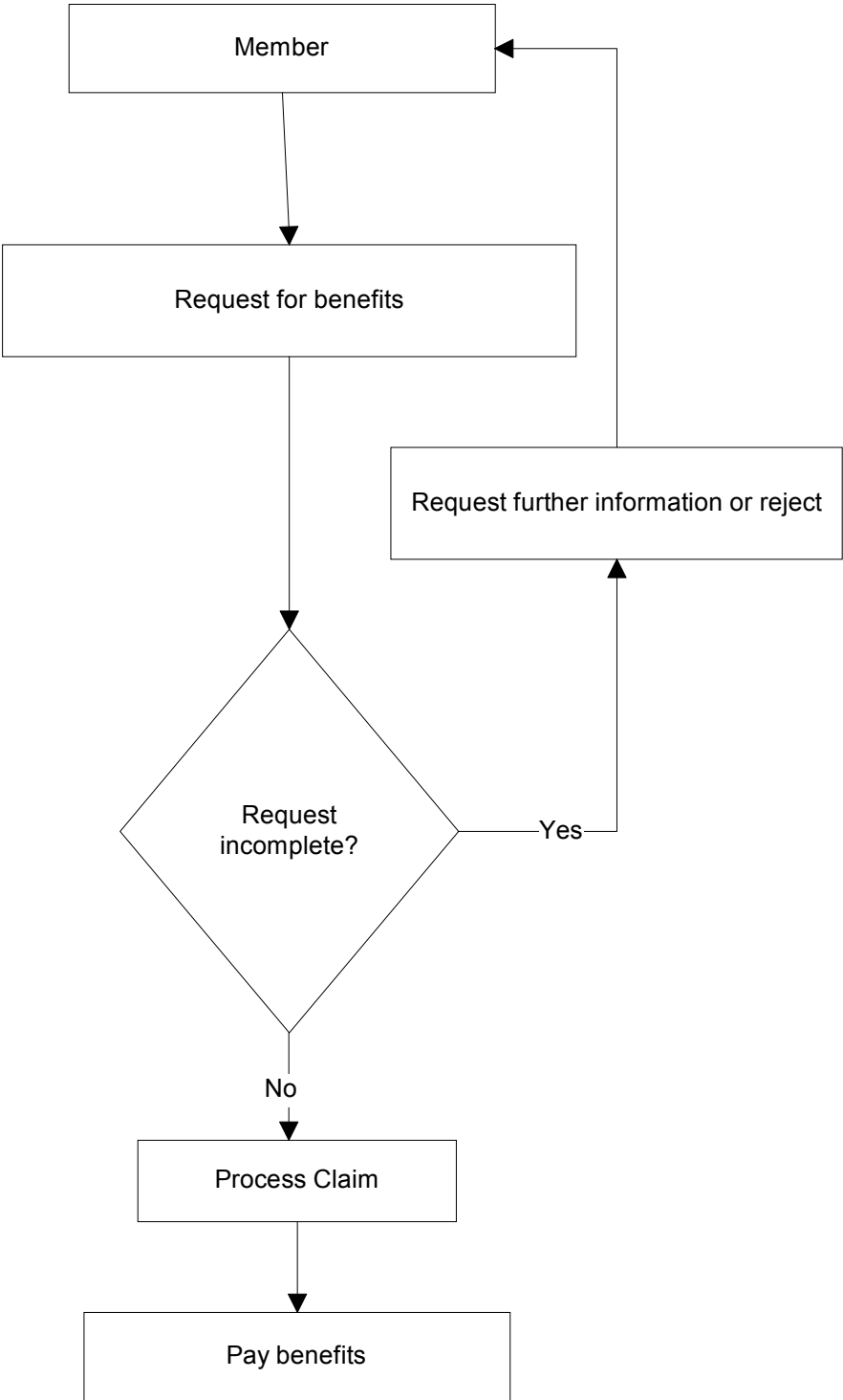
There should be controls in place to ensure that:

- all benefit statements are produced and issued within the appropriate time,
- any which computerised systems fail to produce are highlighted and processes exist to correct computer records and issue a statement by the required deadline,
- checks are made to give confidence that information given on benefit statements is accurate,
- processes exist to deal with all error and warning reports and that any 'missing' reports can be identified and obtained.

| POSSIBLE CONTROLS |   | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|---|----------------------|----------|
| 4.1               | The administration system generates annual benefit statements that are sent to members in a timely manner,<br><br>Amounts disputed by members are investigated in a timely fashion. |                      |          |
| 4.2               | A sample of benefit statements are tested to ensure the mathematical accuracy of system processing through recalculation. Exceptions are reported and resolved.                     |                      |          |
| 4.3               | Access violation attempts and violations to the administration program and master files are investigated and resolved.  |                      |          |
| 4.4               | Unusual items and balances on the administration system are shown on an exception report and reviewed on a regular basis.   |                      |          |

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|--|----------------------|----------|
| 4.5               | Password protection ensures that authorised staff can only make amendments to administration records.                    |                      |          |
| 4.6               | Exception reports are sequentially numbered. Any missing reports are investigated and resolved in a timely manner.       |                      |          |
| 4.7               | Performance monitoring reports are produced promptly in an easily understood form, with only key data being highlighted. |                      |          |
| 4.8               | Timely benefit statements are produced in accordance with the terms of the stakeholder scheme.                           |                      |          |

5 Benefits payable



### Possible controls over benefits payable

This will encompass paying money out when there is a valid claim under the policy e.g. on retirement, death, transfer out, and pension credits being awarded to former spouses. It also covers refunds of contributions in excess of Inland Revenue limits.

Processes ought to be in place to ensure:

- Requests to pay money come from valid sources e.g. member or legal personal representatives;
- Controls exist to make sure the amount paid out is the member's entitlement;
- Controls exist to make sure payments are appropriately authorised;
- There is control of requests to make payments out which ensure payments out are all processed and are processed in a timely manner;
- All error and warning reports are produced and actioned; and
- Controls exist to make sure that payments out are made only in terms of the rules.

| POSSIBLE CONTROLS |   | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|---|----------------------|----------|
| 5.1               | Members are able to ascertain their benefits, for example, through the production of annual and ad hoc benefit statements or, if required, by electronic means. |                      |          |
| 5.2               | Standard forms are used when providing member illustrations.  |                      |          |
| 5.3               | Benefits are only transferred when authorised by the member, the new stakeholder provider and after confirming the member is <i>bona fide</i> .                 |                      |          |
| 5.4               | All benefits payments are approved  |                      |          |

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|--|----------------------|----------|
| 5.5               | Adequate segregation of duties exists between the calculation of benefits due and those authorising payments.          |                      |          |
| 5.6               | From time to time, the internal audit function review the controls surrounding the payment of benefits.                |                      |          |
| 5.7               | Access violation attempts and violations to the administration program and master files are investigated and resolved. |                      |          |
| 5.8               | Password protection ensures that authorised staff can only make amendments to administration records                   |                      |          |
| 5.9               | Charges applied to the purchase of an annuity are reviewed by a senior member of staff to confirm reasonableness.      |                      |          |
| 5.10              | Annuity purchase charges are accounted for in accordance with the applicable regulations.                              |                      |          |
| 5.11              | Adequate documentation is obtained for purchase of an annuity eg birth certificate for proof of age.                   |                      |          |

**6 Service to members, employers and trustees**

| POSSIBLE CONTROLS |  | Good = ✓<br>Weak = X | COMMENTS |
|-------------------|--|----------------------|----------|
| 6.1               | Standards for dealing with member events have been established (for example, the speed of response to notifications of new members, payments of funds, (ie retirements etc) and incorporated into a service level agreement. The provider is able to report against these standards to the interested party. |                      |          |
| 6.2               | A policy document (for an insurance company provider ) is available.   |                      |          |
| 6.3               | Employers' administration of the stakeholder product can be adequately supported - for example by the provision of procedural instructions, telephone help lines etc.  |                      |          |
| 6.4               | If required, provider can accept payment by cheque, direct debit, BACS or over the internet.   |                      |          |
| 6.5               | The charging structure is competitive.   |                      |          |
| 6.6               | The administration software is robust, flexible and modern and able to deal with requirements efficiently.   |                      |          |
| 6.7               | There are checks to ensure the accuracy of charges or other system information.  |                      |          |
| 6.8               | Internal control (FRAG-21) statements if available for the systems which support the provider's product, reveal no significant issues.   |                      |          |

| POSSIBLE CONTROLS |   | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|---|----------------------|----------|
| 6.9               | Annual statements are available from the provider for the trustees in aggregate showing the reconciliation of member movement during the year, opening and closing units and values & movement in cash and units. |                      |          |
| 6.10              | Provider is able to comply with the requirements of SORP, that is, to provide annually the total of the money purchase benefits provided for inclusion in the scheme accounts.<br><br>(Trust-based schemes only). |                      |          |

## 7 Product features

| POSSIBLE CONTROLS |   | Good = ✓<br>Weak = X | COMMENTS |
|-------------------|---|----------------------|----------|
| 7.1               | The product offering is flexible enough to deal with members' reasonable requirements.  |                      |          |
| 7.2               | If required, the provider can deal with lump sum payments from members. Lump sums are invested promptly and evidence of investment can be provided to members.  |                      |          |
| 7.3               | Member switching between investments can be arranged promptly including production of a confirmation letter.  |                      |          |
| 7.4               | If required, the provider can provide facilities to invest through other providers and allocate across multiple providers in a way which is transparent to the operation of the scheme and the members. |                      |          |
| 7.5               | Switching to reduce the volatility of capital values is available as retirement approaches.   |                      |          |
| 7.6               | An ethical option is available if required.   |                      |          |
| 7.7               | There are facilities to move members en bloc from one product to another.   |                      |          |

| POSSIBLE CONTROLS |   | Good = ✓<br>Weak = ✗ | COMMENTS |
|-------------------|---|----------------------|----------|
| 7.8               | Members are able to ascertain their benefits, for example, through the production of annual and ad hoc benefit statements or, if required, by electronic means. |                      |          |
| 7.9               | Reporting is available in respect of members who are no longer contributing, as well as active members.   |                      |          |
| 7.10              | If necessary, record keeping should include the members' status with respect to pension splitting.  |                      |          |
| 7.11              | The level of interest rate that would apply between the date the member retired and the date payment is made is adequate.                                       |                      |          |

### **III. INVESTMENT MANAGEMENT AND CUSTODY CONTROLS**

#### **Introduction**

The investment management function of a pension scheme is quite possibly the most important component in determining the level of the pension of a member. With the advent of Stakeholder, this is even more pronounced given the transparency of the product and the minimum conditions set on the cost and charges to the funds.

The challenge to the investment management industry is to provide potential members with a quality product offering a wide range of funds together with the assurance that the costs will be within the limits set by the Stakeholder Manager/Trustee Board.

The choice of investment manager for the fund will have a direct impact on the final value of the funds available to purchase the stakeholder pension. Positive returns should be linked with robust risk management and well monitored internal controls.

#### **Stakeholder overview**

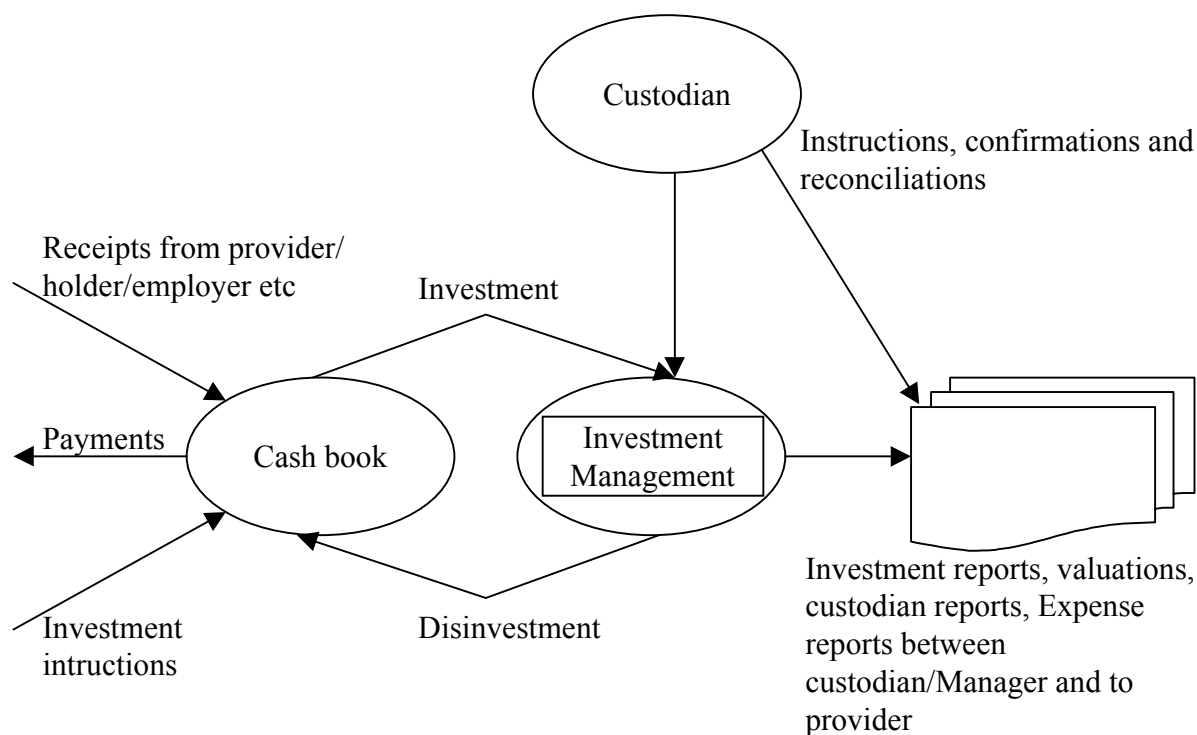
The investment management and custody arrangements under a stakeholder environment will be varied across the industry given the different types of entities offering a stakeholder scheme. The main parties involved will be both the insurance providers and the large asset managers. The administration process may also be handled by the same company (or group) or carried out by a third party provider – so-called “un-bundling” of these two functions.

#### **Understanding of the transaction flows**

Obtaining an understanding of the investment management and custody process under a stakeholder environment should address:

- How are business transactions, events and facts are communicated from the administration system to the investment management process?
- What funds are being offered to potential members?
- How is data input and how are changes made?
- How does the data transfer occur?
- How are these transactions communicated and reconciled to the custodian?
- What is the output of the process?

The diagram overleaf provides an overview of the information flows of the investment management and custody function of a stakeholder pension scheme.



### Identify and source risks

The checklists cover the following risk areas that are considered to be integral components of the investment management and custody process:

- Appendix III/A: General;
- Appendix III/B: Investment objectives, policy and restrictions;
- Appendix III/C: Authorisation procedures;
- Appendix III/D: Transaction processing;
- Appendix III/E: Asset existence and recording;
- Appendix III/F: Income collection;
- Appendix III/G: Expenditure and charges;
- Appendix III/H: Cash management;
- Appendix III/I: Unitised funds;
- Appendix III/J: With-profits funds;
- Appendix III/K: Compliance;
- Appendix III/L: Security and contingency procedures;
- Appendix III/M: Custody administration;
- Appendix III/N: Sub-custodian network;
- Appendix III/O: Taxation; and
- Appendix III/P: Reporting requirements.

---

## Checklists

Included in this section are checklists identifying examples of possible controls that trustees/stakeholder managers should look for within the investment management and custody functions, whether performed in-house (or within the same group) or delegated to a third-party firm.

The controls listed should operate to reduce the risks associated with operating a stakeholder pension scheme. They include the main areas of organisational and operational risk as well as detailing the reporting requirements as laid down by the Stakeholder Regulations.

It is not intended that the examples should be regarded as exhaustive and the relevance of particular controls will be dependent on the specific risks of the investment management/custody mandate, market and portfolio. In particular, the segregation of duties assumed may not be achievable for practical reasons at a smaller investment manager.

### *Definitions*

The following checklists make reference to a number of functions and titles. Whilst these should not be taken to refer to specific job titles within a particular investment management firm or custodian (reference to which is not intended), they indicate functional segregation required for internal control purposes.

#### *Administrator or Accountant*

Someone who has to manage the reporting process to trustees/managers and other third parties.

#### *Investment Manager*

The investment firm appointed by the stakeholder pension scheme manager/trustees to manage a portfolio of investments.

#### *Senior Management*

Directors or Senior Managers responsible for departmental operations.

#### *Portfolio Manager*

The principal investment manager responsible for the stakeholder pension scheme's portfolio.

#### *Chief Dealer*

Person responsible for the activities of other Dealers.

#### *Dealers*

Staff responsible for buying and selling securities.

#### *Compliance Officer*

Person appointed by the firm who has the legal responsibility to ensure that the firm complies with the rules and regulations of the FSA.

#### *Compliance Department*

The staff reporting directly to the compliance officer who monitor day to day operations.

---

**INVESTMENT MANAGEMENT CONTROLS**
**1. GENERAL**

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 1.1               | <b>Organisation:</b>   |                      |          |
| 1.1.1             | The management structure and reporting lines are clearly defined and fully documented.   |                      |          |
| 1.1.2             | Levels of delegated authority are defined and documented.  |                      |          |
| 1.1.3             | There is a "Hands-on" management style   |                      |          |
| 1.1.4             | An open door policy to <i>Senior Management</i> exists both in principle and in practice.  |                      |          |
| 1.1.5             | Working practices and policies, including a provision for "whistleblowing" by the relevant parties, as laid down in the Stakeholder Regulations and FSA rules, should be documented.                       |                      |          |
| 1.1.6             | Peer and management review controls are in operation. These are particularly appropriate if the <i>Investment Manager</i> operates a "star" rather than a team environment for <i>Portfolio Managers</i> . |                      |          |
| 1.1.7             | Staff turnover levels are comparable with prior years and industry averages.   |                      |          |
| 1.1.8             | Overseas and branch offices operate under similar control policies and disciplines and are subject to review by <i>Compliance Department</i> .   |                      |          |

---

| POSSIBLE CONTROLS |  | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|--|---------------------------------|----------|
| 1.1.9             | A Service Level Agreement is in place between the Stakeholder manager or Board of Trustees and the <i>Investment Manager</i> . |                                 |          |

## 2. INVESTMENT OBJECTIVES, POLICY AND RESTRICTIONS

| POSSIBLE CONTROLS |   | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|---|---------------------------------|----------|
| 2.1               | <b>Internal:</b>  |                                 |          |
| 2.1.1             | The <i>Investment Manager</i> has a recognised and consistent house style which is maintained and developed by senior management.   |                                 |          |
| 2.1.2             | Procedures are in place to ensure that notifiable holdings are disclosed to the UK Listing Authority and/or any other regulator as required.  |                                 |          |
| 2.1.3             | Front office systems allow the positions taken by <i>Portfolio Managers</i> to be monitored against policy. Significant deviations in performance for portfolios with a similar mandate are visible to and actively managed by <i>Senior Management</i> . |                                 |          |
| 2.1.4             | Research recommendations are monitored and subject to quality control procedures and peer review.   |                                 |          |
| 2.2               | <b>Client Objectives Policies and Restrictions:</b>   |                                 |          |
| 2.2.1             | The objectives policies and restrictions relating to the fund/portfolio are defined in the investment management agreement which is accessible to the <i>Portfolio Manager</i> .  |                                 |          |
| 2.2.2             | The <i>Portfolio Manager</i> is responsible for compliance within the restrictions of the fund/portfolio/trust deed or stakeholder contract. He checks these restrictions (and evidences this) prior to issuing an intention to deal advice.              |                                 |          |

| POSSIBLE CONTROLS |   | Good = √<br>Weak = x | COMMENTS |
|-------------------|---|----------------------|----------|
| 2.2.3             | Procedures are in place to confirm that no stakeholder scheme assets should be represented by units/shares in a collective investment scheme (or by rights under a contract of insurance where expressed as units/shares in funds) unless it is a requirement that the purchase and sale price do not differ from each offer. |                      |          |
| 2.2.4             | Procedures are in place to monitor asset allocation and ensure that it complies with stated objectives (i.e. Performance Criteria, Benchmark, SIP, stakeholder regulations etc)   |                      |          |
| 2.2.5             | Progress of the fund/portfolio against its objectives is monitored regularly and action is taken to correct where necessary on a timely basis.  |                      |          |
| 2.2.6             | Details of fund/portfolio restrictions are maintained in a format (e.g. Database) which can be easily interrogated and ideally are electronically embedded into operating systems.  |                      |          |
| 2.2.7             | Procedures are in place to identify investment management costs, differentiating between those which are permitted expenses and those which are charged to members.   |                      |          |
| 2.2.8             | Costs are closely monitored to ensure compliance with the investment management agreement and the contract with scheme members.   |                      |          |

|        |  |  |  |
|--------|--|--|--|
| 2.2.9  | Records are updated immediately when authorised changes to objectives, policies and/or restrictions are received.  |  |  |
| 2.2.10 | Procedures are in place to record and act on standing instructions from trustees or Stakeholder manager e.g. voting, dividend reinvestment plans, Socially Responsible Investment etc. |  |  |
| 2.2.11 | The <i>investment manager</i> has a copy of the scheme's current Statement of Investment Principles.   |  |  |

### 3. AUTHORISATION PROCEDURES

| POSSIBLE CONTROLS |   | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|---|---------------------------------|----------|
| 3.1               | <b>Controls:</b>  |                                 |          |
| 3.1.1             | Client authorised signatories, level of authorisation and bank details are maintained for each fund/portfolio.  |                                 |          |
| 3.1.2             | Details of the approved method of communication for each fund/portfolio are maintained. This should include the lines of communication between the stakeholder manager, fund manager and custodian. |                                 |          |
| 3.1.3             | Transfers of assets in or out of the scheme occur only on receipt of written instructions (or other secure approved method).  |                                 |          |
| 3.1.4             | Instructions for switching investments from one investment option to another occur only on receipt of authorisation by the administrator, or if permitted, directly from the member.                |                                 |          |
| 3.1.5             | On receipt of a trustee or stakeholder manager generated instruction all details are checked against the standing information for the fund/portfolio and this check is evidenced.                   |                                 |          |
| 3.1.6             | All instructions are authorised by the fund manager prior to processing.  |                                 |          |

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 3.1.7             | Only authorised instructions are passed to the custodian.  |                      |          |
| 3.1.8             | Agreements allow the <i>Portfolio Manager</i> to disregard an instruction (and if necessary inform the relevant regulatory authority) if an instruction appears to be exceptional or potentially fraudulent and to arrange a telephone call-back to an independent person at the trustee or stakeholder manager. |                      |          |
| 3.1.9             | If the fund/portfolio has a master agreement with the custodian the responsibility for checking instructions will lie with the custodian but the <i>Portfolio Manager</i> should apply standard procedures to any instruction to disinvest.  |                      |          |
| 3.1.10            | Delivery of stock to brokers is made only against payment. The <i>Portfolio Manager</i> should assess counterparty risk and manage it as part of the investment decision, without taking responsibility for the broker default.  |                      |          |
| 3.1.11            | Payment for stock is made only against delivery in line with specific market practices.  |                      |          |
| 3.1.12            | Transactions where delivery is not against payment (e.g. foreign exchange, new issues and short-term money market transactions) are authorised by <i>Senior Management</i> and custodian procedures ensure that this authorisation is to hand before settlement.   |                      |          |
| 3.1.13            | Payment for new issues and placings is made only on receipt of a placing letter from the broker.   |                      |          |

## 4. TRANSACTION PROCESSING

| POSSIBLE CONTROLS |  | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|--|---------------------------------|----------|
| 4.1               | <b>Dealing:</b>  |                                 |          |
| 4.1.1             | Dealing and settlement functions are segregated.   |                                 |          |
| 4.1.2             | Intention to deal advices with time and date are completed.  |                                 |          |
| 4.1.3             | <i>Dealer</i> Checks calculation of deal advice and availability of cash/shares.   |                                 |          |
| 4.1.4             | A central list of approved brokers is maintained.  |                                 |          |
| 4.1.5             | The list of approved brokers is frequently reviewed by senior management.  |                                 |          |
| 4.1.6             | Brokers are used only if they provide an adequate level of service and have sufficient financial resources and safeguards.           |                                 |          |
| 4.1.7             | Service level agreements are in place with all brokers.  |                                 |          |
| 4.1.8             | Commission allocation targets are set annually and are reported on a monthly basis. These are reviewed by <i>Senior Management</i> . |                                 |          |

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 4.1.9             | Telephone conversations with brokers are recorded and the recording system is regularly tested to ensure that it is effective.   |                      |          |
| 4.1.10            | Dealing in unlisted securities is monitored by the <i>Chief Dealer</i> to ensure justification and correct valuation.  |                      |          |
| 4.1.11            | Dealing can take place throughout the day with full cover of the major international markets (e.g. London, New York, Tokyo).   |                      |          |
| 4.1.12            | <i>Dealer</i> is accountable to the <i>Portfolio Manager</i> .   |                      |          |
| 4.1.13            | <i>Dealer</i> Discretion over price ranges is set by the <i>Portfolio Manager</i> .  |                      |          |
| 4.1.14            | Systems are in place to ensure best execution of instructions (e.g. comparison with value weighted average prices for the day for overseas markets and with high low close volume data for the UK and Europe) and equitable allocation between multiple clients. |                      |          |
| 4.1.15            | Pre-numbered dealing slips are used to ensure completeness of trading and the records of these are reviewed by <i>Compliance Department</i> at regular intervals.  |                      |          |
| 4.1.16            | A dealing order book is maintained   |                      |          |

| POSSIBLE CONTROLS |   | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|---|---------------------------------|----------|
| 4.1.17            | Guidelines exist to cover procedures in the event of partial execution.   |                                 |          |
| 4.1.18            | Outstanding and completed deals are reported daily.   |                                 |          |
| 4.1.19            | Details of all deals are immediately recorded on the accounting system to update client portfolio records.  |                                 |          |
| 4.1.20            | The <i>portfolio manager</i> reviews and confirms all deals.  |                                 |          |
| 4.1.21            | Paper and electronic records and tapes of telephone conversations are retained securely for a significant period (e.g. at least 6 years).   |                                 |          |
| 4.2               | <b>Personal and Company Account Trading</b>   |                                 |          |
| 4.2.1             | If allowed, personal and on company account trading is approved pre-trade by the <i>Chief Dealer</i> on a daily basis and monitored by <i>Senior Management and Compliance Department</i> . |                                 |          |
| 4.3               | <b>Settlement:</b>  |                                 |          |
| 4.3.1             | Brokers confirm every deal by a standardised/secure method (e.g. electronic trade confirmation, telex or hard copy contract note etc.).   |                                 |          |

| POSSIBLE CONTROLS |   | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|---|---------------------------------|----------|
| 4.3.2             | Broker confirmations are matched and checked against dealing slips.                               |                                 |          |
| 4.3.3             | Discrepancies are followed up immediately   |                                 |          |
| 4.3.4             | Unconfirmed deals are immediately followed up and reported to dealers.                            |                                 |          |
| 4.3.5             | Contract notes are checked independently by the settlement and accounting functions.              |                                 |          |
| 4.3.6             | All transactions are processed by the settlement function and checked by the accounting function. |                                 |          |
| 4.3.7             | Deals are authorised by the <i>Portfolio Manager</i> before advising the custodian of the deal.   |                                 |          |
| 4.3.8             | Communication with custodians is monitored to ensure that daily "cut-off" times are met.          |                                 |          |
| 4.3.9             | The custodian assumes responsibility for advising of failed trades.                               |                                 |          |

| POSSIBLE CONTROLS |  | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|--|---------------------------------|----------|
| 4.3.10            | There are procedures in place to highlight and investigate unusual transactions and special situations.  |                                 |          |
| 4.3.11            | The progress of failed trades are followed up (and resolved) with the broker and custodian on a daily basis to ensure settlement of the trade.           |                                 |          |
| 4.4               | <b>Foreign Exchange:</b>   |                                 |          |
| 4.4.1             | Currency transactions required to match deals are advised on a daily basis.  |                                 |          |
| 4.4.2             | If currency deals are traded with the client's custodian bank, the rates are compared with a third-party source (e.g. Reuters) to ensure best execution. |                                 |          |
| 4.4.3             | Limits rate set, above which competitive quotes must be sought from approved banks.  |                                 |          |
| 4.4.4             | The credit ratings of counterparty banks used for foreign exchange deals are reviewed regularly.   |                                 |          |
| 4.4.5             | Only approved counterparty banks are used for foreign exchange deals and limits on exposure are maintained.  |                                 |          |
| 4.4.6             | Currency dealing slips are produced and time stamped.  |                                 |          |

| POSSIBLE CONTROLS |   | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|---|---------------------------------|----------|
| 4.4.7             | Details of foreign currency deals are immediately recorded on the accounting system to update client portfolio records.   |                                 |          |
| 4.4.8             | Confirmation of trades is received from the counterparty bank on the same day/immediately by fax or other suitable method.  |                                 |          |
| 4.4.9             | The counterparty confirmation is matched and checked to the foreign exchange dealing slip.  |                                 |          |
| 4.4.10            | Discrepancies are immediately followed up and reported/escalated to <i>Senior Management</i> if necessary.  |                                 |          |
| 4.4.11            | Currency dealing slips are authorised by the <i>Portfolio Manager</i> .   |                                 |          |
| 4.5               | <b>Derivatives:</b>   |                                 |          |
| 4.5.1             | Derivatives are used only where the trustees/manager has given permission and <i>Senior Management</i> authorise all such trading on evidence that it complies with any restrictions in the client agreement. |                                 |          |

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 4.5.2             | Open contracts are monitored on a daily basis.   |                      |          |
| 4.5.3             | Periodic (e.g. month end) positions with counterparties are agreed to their confirmations which are requested if necessary.  |                      |          |
| 4.5.4             | The use of derivatives is restricted to specific investment objectives (e.g. hedging of cash flows or enabling asset allocation movements) as defined by the client agreement. |                      |          |
| 4.5.5             | <i>Senior Management</i> are aware of the nature and risks of derivatives (including value and measurement) and have a stated risk management policy.                          |                      |          |
| 4.4.6             | Client restrictions are checked before intention to deal note is authorised.   |                      |          |
| 4.5.7             | Margin requirements are calculated on a daily basis and agreed to broker's statements and discrepancies resolved. This may be delegated to the custodian.                      |                      |          |
| 4.5.8             | Margin payments are authorised by the <i>Portfolio Manager</i> .   |                      |          |
| 4.5.9             | Individual <i>Portfolio Managers</i> are responsible for ensuring that exposures are monitored for credit risk.  |                      |          |

| POSSIBLE CONTROLS |   | Good = √<br>Weak = x | COMMENTS |
|-------------------|---|----------------------|----------|
| 4.5.10            | Dealing instructions and transfers are monitored separately by <i>Compliance Department</i> .   |                      |          |
| 4.6               | <b>Stock Lending</b>  |                      |          |
| 4.6.1             | Controls are maintained over stock lending to ensure that stock is lent only where allowed by the management agreement and is permitted by the stakeholder scheme rules and an appropriate level of collateral is received. |                      |          |
| 4.7               | <b>Reporting</b>  |                      |          |
| 4.7.1             | Management reports are produced on a regular and timely basis and are reviewed by <i>Senior Management</i> .  |                      |          |
| 4.7.2             | Tax reports are prepared to enable clients to meet the reporting requirements of the self-assessment system (including underwriting, investment income, tax reclamation).   |                      |          |

## 5. ASSET EXISTENCE &amp; RECORDING

| POSSIBLE CONTROLS |  | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|--|---------------------------------|----------|
| 5.1               | <b>Controls:</b>   |                                 |          |
| 5.1.1             | Full reconciliations are prepared to the custodian's records at least monthly.   |                                 |          |
| 5.1.2             | Discrepancies between internal and external records are followed up immediately and reports on these are reviewed by <i>Senior Management</i> .      |                                 |          |
| 5.1.3             | Procedures exist to record and report differences to custodians and follow up if not resolved.   |                                 |          |
| 5.1.4             | Prices are checked to a third party provider (e.g. Reuters or Datastream).   |                                 |          |
| 5.1.5             | System reports which will identify large and potentially incorrect price movements are employed and regularly reviewed by <i>Senior Management</i> . |                                 |          |
| 5.1.6             | Independent reviews are undertaken and records maintained of the manual pricing process.   |                                 |          |
| 5.1.7             | Systems are in place to separately identify and review the valuation of manually priced / unquoted stocks.   |                                 |          |
| 5.1.8             | Systems are in place to ensure an accurate split between different portfolios held in the same nominee name.   |                                 |          |

## 6. INCOME

| POSSIBLE CONTROLS |   | Good = $\surd$<br>Weak = x | COMMENTS |
|-------------------|---|----------------------------|----------|
| 6.1               | <b>Monitoring:</b>  |                            |          |
| 6.1.1             | Information is obtained from a third-party source and is used to create a summary of income receivable by the fund/portfolio during a period.                     |                            |          |
| 6.1.2             | Income received is agreed to vouchers received from the custodian and calculations of amounts are checked, and discrepancies reported and resolved without delay. |                            |          |
| 6.1.3             | Actual income received is detailed and reconciled to the expected income.   |                            |          |
| 6.1.4             | The income reconciliation is performed frequently and is independently reviewed at least monthly.   |                            |          |
| 6.1.5             | Any investment income not received within 2 weeks of the expected date is followed up with the custodian.   |                            |          |
| 6.1.6             | Custodian has responsibility to advise the manager of corporate actions (e.g. scrip issues).  |                            |          |
| 6.1.7             | Custodian information is checked by staff independent of the reconciliation function against that provided by a third-party before being processed.               |                            |          |

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 6.2               | <b>Stakeholder Regulations</b>   |                      |          |
| 6.2.1             | Where monies of the scheme are held on deposit, there should be systems in place to ensure that the return accruing on a daily basis is, net of any fees or charges, not less than the base rate minus 2% per annum. |                      |          |
| 6.2.2             | If monies are held on deposit, the manager is able to change the interest rate applied within one calendar month of the change in the base rate.   |                      |          |
| 6.2.3             | Controls should be in place to ensure that all income is “ring-fenced” as stakeholder and can be separately identified from income received on other funds held.   |                      |          |

## 7. EXPENDITURE AND CHARGES

| POSSIBLE CONTROLS |   | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|---|---------------------------------|----------|
| 7.1               | <b>Stakeholder Regulations</b>  |                                 |          |
| 7.1.1             | Controls should be in place to ensure that all expenditure is “ring-fenced” as stakeholder and is separately held from other non-stakeholder funds.   |                                 |          |
| 7.1.2             | The value of the fund may be reduced by the making of deductions no greater than 1/365% of the value for each day held in a stakeholder scheme.   |                                 |          |
| 7.1.3             | The value of members’ rights may be reduced only in specified circumstances, where administrative expenses are incurred by the trustee/stakeholder manager and these meet the criteria set out in the stakeholder regulations.  |                                 |          |
| 7.1.4             | Any other services, other than those relating to the management of scheme, should have an agreed fee and terms of engagement or are provided at no cost to the members.   |                                 |          |
| 7.1.5             | For the purpose of the annual management charge, members’ rights should be valued either daily/weekly or monthly. The trustee/stakeholder manager should specify either a day (if valued weekly) or a date (if monthly) on which members’ rights are valued. This policy cannot change for a period of twelve months. |                                 |          |
| 7.1.6             | All records detailing members’ rights and fees charged should be kept for an appropriate number of years (but not less than six).   |                                 |          |

## 8. CASH MANAGEMENT

| POSSIBLE CONTROLS |   | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|---|---------------------------------|----------|
| 8.1               | <b>Transfers:</b>   |                                 |          |
| 8.1.1             | Instructions to transfer cash balances for the purposes of cash management are authorised by <i>Senior Management</i> .                     |                                 |          |
| 8.2               | <b>Reconciliations:</b>   |                                 |          |
| 8.2.1             | Frequent (e.g. weekly) reconciliations are performed between the custodian's and internal cash balance records.                             |                                 |          |
| 8.2.2             | All bank reconciliations are reviewed and this review is evidenced.   |                                 |          |
| 8.2.3             | Bank reconciliations are subject to frequent review by <i>Compliance Department</i> .   |                                 |          |
| 8.3               | <b>Deposit limits:</b>  |                                 |          |
| 8.3.1             | Limits (in either % or value terms) are placed on the amount of cash which can be held by the custodian for any one fund/portfolio.         |                                 |          |
| 8.3.2             | If deposits are placed with a bank associated with the <i>Investment Manager</i> then an appropriate limit is applied.                      |                                 |          |
| 8.3.3             | Banks used to deposit surplus uninvested cash are limited to those approved by senior management and those approved are regularly reviewed. |                                 |          |

| POSSIBLE CONTROLS |  | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|--|---------------------------------|----------|
| 8.3.4             | A third-party rating service (e.g. S&P/IBCA) is used to evaluate deposit banks.  |                                 |          |
| 8.3.5             | Mandates with deposit banks are standardised and limit transfer of funds so that they can be paid only back to the fund/portfolio account with the relevant custodian. |                                 |          |
| 8.3.6             | The trustee or stakeholder manager is responsible for approving deposit banks for the scheme.  |                                 |          |
| 8.3.7             | Limits are imposed on the maximum value of amounts deposited overnight with each bank to ensure that any risk is adequately spread.                                    |                                 |          |
| 8.3.8             | Where pooled accounts are held for a number of trustees/managers, the amounts held are reconciled on a daily basis.  |                                 |          |

## 9. UNITISED FUNDS

| POSSIBLE CONTROLS |   | Good = <input checked="" type="checkbox"/><br>Weak = x | COMMENTS |
|-------------------|---|--|----------|
| 9.1               | <b>Controls:</b>  |  |          |
| 9.1.1             | Unitised funds are managed and administered by the investment manager within the structure of the stakeholder scheme  |  |          |
| 9.1.2             | The unitised funds share the same dealing, settlement, treasury and administration functions as the rest of the investment management operation.  |  |          |
| 9.1.3             | There is no difference in visibility within the manager for trades executed for the unitised funds versus those executed for other clients.   |  |          |
| 9.1.4             | Restrictions are placed on the investment activities of the unitised funds in relation to e.g. unlisted securities and maximum individual holdings and are maintained in a format (e.g. Database) which can be easily interrogated. |  |          |
| 9.1.5             | Details of holdings held both through unitised funds and directly for a single fund are managed jointly for the purposes of risk.   |  |          |
| 9.1.6             | Investment in derivatives by unitised funds is controlled by a written risk control policy and monitored on a daily basis by an <i>Senior Management</i> .  |  |          |
| 9.1.7             | Where funds are unitised, there is a documented process for the calculation and allocation of units.  |  |          |

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 9.1.8             | When the investment objective of the unitised fund is to index-track, adequate monitoring controls are in place to ensure that required trades are undertaken and this is evidenced by the fund closely following the target index.  |                      |          |
| 9.1.9             | The <i>Portfolio Manager</i> is responsible for compliance with the restrictions of the fund/portfolio/trust deed or stakeholder contract. He checks these restrictions (and evidences this) prior to issuing an intention to deal advice.   |                      |          |
| 9.1.10            | No stakeholder scheme assets should be represented by units/shares in a collective investment scheme (or by rights under a contract of insurance where expressed as units/shares in funds) unless it is a requirement that the purchase and sale price do not differ from each offer |                      |          |
| 9.1.11            | An appropriate official should monitor the unitisation process of the portfolio assets and liabilities for member allocation purposes. A regular reconciliation should be performed between the total funds held and the total of members' accounts.                                 |                      |          |

| POSSIBLE CONTROLS |   | Good = √<br>Weak = x | COMMENTS |
|-------------------|---|----------------------|----------|
| 9.1.12            | <p>As part of the unitisation process, there should be controls over the following:</p> <ul style="list-style-type: none"> <li>• Validity and accuracy of the pricing formula calculation;</li> <li>• Certification of new/cancelled units;</li> <li>• Review of “unit book” for possible purchase/sale mismatches;</li> <li>• Existence of unallocated units;</li> <li>• Equalisation (if applicable);</li> <li>• Treatment of fractions/roundings;</li> <li>• The processes by which units are credited to members’ accounts; and</li> <li>• Detailed reporting if unit reconciliation movements to stakeholder managers/trustees.</li> </ul> |                      |          |

**10. WITH-PROFITS FUNDS**

| POSSIBLE CONTROLS |  | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|--|---------------------------------|----------|
| 10.1              | Investments are made in a with-profits fund that is designated solely for stakeholder scheme assets (Regulation 15)  |                                 |          |
| 10.2              | A contract exists whereby the insurance company undertakes to provide the trustees/manager with the information required to comply with Regulations 13, 14 and 15. |                                 |          |
| 10.3              | Bonuses declared are in line with the agreement between the Trustees and insurance company.  |                                 |          |
| 10.4              | An annual certificate from the auditor/actuary of the insurance company has been issued to the trustees/manager.   |                                 |          |
| 10.5              | Agents are subject to regulatory disciplines either because of local law or because of their status as part of a regulated group.                                  |                                 |          |
| 10.6              | A regular assessment of the financial strength of the insurance company is made to ascertain if there is any risk to the bonus payments.                           |                                 |          |

## 11. COMPLIANCE

| POSSIBLE CONTROLS |   | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|---|---------------------------------|----------|
| 11.1              | <b>Compliance Department</b>  |                                 |          |
| 11.1.1            | The <i>Investment Manager</i> has a <i>Compliance Department</i> which has responsibility for ensuring compliance with internal procedures and external regulatory authorities.   |                                 |          |
| 11.1.2            | The <i>Compliance Department</i> is adequately resourced and has free access to Directors and <i>Senior Management</i> .  |                                 |          |
| 11.1.3            | The <i>Compliance Department</i> has a specialised computer audit team to review system issues.   |                                 |          |
| 11.1.4            | <i>Compliance Department</i> has a stated plan to regularly monitor trading and funds/portfolios to ensure that restrictions are being complied with (eg Statement of Investment Principles, Socially Responsible Investment, listing requirements, Pensions Act 1995, Welfare Reform and Pensions Act 1999 and the Stakeholder Regulations). Issues raised are resolved and solutions implemented. |                                 |          |
| 11.1.5            | Procedures are in place to report portfolio turnover to demonstrate fair dealing and lack of "churning".  |                                 |          |
| 11.2              | <b>Regulatory Environment</b>   |                                 |          |
| 11.2.1            | The investment management business is conducted subject to regulation by the relevant regulatory authorities (e.g. FSA, SEC).   |                                 |          |

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 11.2.2            | Procedures exist to inform the <i>Portfolio Manager</i> of FSA rule book changes and other regulatory requirements or limitations.   |                      |          |
| 11.2.3            | The <i>Investment Manager</i> does not provide an in-house custody/safe-keeping service (If "yes" refer to "Safe Custody Risks - A Checklist for Trustees").   |                      |          |
| 11.2.4            | Confirm that no reports of irregularities have been issued by the regulatory authority or statutory auditor / reporting accountant.  |                      |          |
| 11.2.5            | Identify when the most recent visits were made by the regulatory authorities and the reasons for these visits. Request copies of any reports resulting from them.  |                      |          |
| 11.3              | <b>Stakeholder Regulations</b>   |                      |          |
| 11.3.1            | For contract-based schemes:<br>If the Investment manager selects the portfolio options, the compliance officer should be asked to confirm that the reasons why the investment category has been chosen and is considered to be appropriate and these are recorded in writing.                |                      |          |
| 11.3.2            | If the <i>Investment Manager</i> holds client money (for example as a results of operating a cash pool for short-term deposits) then the <i>Compliance Officer</i> should be asked to confirm whether there have been any significant breaches reported to FSA during the accounting period. |                      |          |

| POSSIBLE CONTROLS |   | Good = $\surd$<br>Weak = x | COMMENTS |
|-------------------|---|----------------------------|----------|
| 11.4              | <b>Staff</b>  |                            |          |
| 11.4.1            | All working practices including compliance procedures and reporting are documented and staff within the <i>investment manager</i> are aware of their reporting responsibilities and rights. |                            |          |
| 11.4.2            | Staff are able to report any concerns to the <i>compliance officer</i> confidentially.  |                            |          |
| 11.4.3            | The FSA training and competence arrangements for front-office and administration staff are met.   |                            |          |

## 12. SECURITY AND CONTINGENCY PROCEDURES

| POSSIBLE CONTROLS |  | Good = $\sqrt{\square}$<br>Weak = x | COMMENTS |
|-------------------|--|-------------------------------------|----------|
| 12.1              | <b>Physical security:</b>  |                                     |          |
| 12.1.1            | Access to all areas of the investment management operation is controlled and access is restricted to authorised personnel.   |                                     |          |
| 12.1.2            | Remote alarms to report fire flood smoke overheating or unauthorised access are employed in critical areas of the operation. |                                     |          |
| 12.2              | <b>System Security:</b>  |                                     |          |
| 12.2.1            | All users are bound by an IT code of conduct and ethics  |                                     |          |
| 12.2.2            | System access is controlled by hierarchical usernames and passwords  |                                     |          |
| 12.2.3            | Users are permitted access only to those systems which they require for their functional responsibilities.                   |                                     |          |
| 12.2.4            | Data transferred between remote systems is encrypted before transfer.  |                                     |          |

| POSSIBLE CONTROLS |  | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|--|---------------------------------|----------|
| 12.2.5            | Procedures for virus protection of the system are in place.  |                                 |          |
| 12.2.6            | Virus protection software is updated with latest versions on a regular basis.                              |                                 |          |
| 12.2.7            | Backup of all data takes place in accordance with standard procedures on daily, weekly and monthly cycles. |                                 |          |
| 12.2.8            | Backup data is held in a secure location off-site.   |                                 |          |
| 12.3              | <b>Disaster Recovery Planning:</b>   |                                 |          |
| 12.3.1            | Each function within the operation has a tested contingency plan.  |                                 |          |
| 12.3.2            | The contingency plans are fully tested on an annual basis.   |                                 |          |
| 12.4              | <b>Insurance Cover:</b>  |                                 |          |
| 12.4.1            | Adequate Professional Indemnity Insurance is held by the investment Manager.                               |                                 |          |
| 12.4.2            | Adequate general insurance cover is held by the investment manager   |                                 |          |

**CUSTODY CONTROLS****13. CUSTODIAN ADMINISTRATION**

| <b>POSSIBLE CONTROLS</b> |  | <b>Good = √<br/>Weak = x</b> | <b>COMMENTS</b> |
|--------------------------|--|------------------------------|-----------------|
| 13.1                     | The custodian has substantial financial reserves and is part of an established, credit-worthy group.   |                              |                 |
| 13.2                     | The ultimate holding company is prepared to “stand-behind” the custodian company.  |                              |                 |
| 13.3                     | Where safe custody is only one of several activities conducted by the business, there is clearly established separation in the management of the different activities. |                              |                 |
| 13.4                     | There is a well defined and appropriate management structure.  |                              |                 |
| 13.5                     | Any branches in the sub-custodian network are subject to the same controls as the financial custodian.   |                              |                 |
| 13.6                     | The custodian is subject to regulation by UK, US or other regulatory bodies  |                              |                 |
| 13.7                     | Internal auditors operate independently of the safe custody management.  |                              |                 |
| 13.8                     | Review visits by scheme reporting accountants can be accommodated.   |                              |                 |
| 13.9                     | Where applicable a current unqualified FRAG 21 or SAS 70 report is available.  |                              |                 |
| 13.10                    | The main custodian is prepared to “stand-behind” its sub-agents.   |                              |                 |

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 13.11             | There is a realistic level of insurance cover or indemnification in respect of sub-custodians.   |                      |          |
| 13.12             | An up to date agreement which clearly sets out the relationships between trustees, stakeholder managers, investment managers, custodians and sub-custodians. |                      |          |
| 13.13             | Clearly defined procedures for the authorisation and communication of instructions from the fund manager.  |                      |          |
| 13.14             | Clearly defined procedures for the monitoring and control of systems for the communication of information to the fund manager.                               |                      |          |
| 13.15             | Procedures to ensure that investment restrictions are monitored.   |                      |          |
| 13.16             | Safeguards to ensure confidentiality of client information.  |                      |          |
| 13.17             | Adequate programmes of staff training  |                      |          |
| 13.18             | Procedures to minimise disruption and threats to systems and controls resulting from staff changes and absences.   |                      |          |
| 13.19             | Established computer controls including use of passwords, restricted access, adequate and frequent back-ups and scheduled reviews of systems.                |                      |          |
| 13.20             | Computer systems and controls are subject to scheduled computer audit work.  |                      |          |

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 13.21             | Adequate planning for disaster recovery.   |                      |          |
| 13.22             | Provision for formal written reporting by the fund manager to the trustees/stakeholder managers on the level of service provided by the custodian.           |                      |          |
| 13.23             | Restricted access to custody area. Unsupervised individuals are not admitted to the area.  |                      |          |
| 13.24             | Physical security of the area including fire precautions.  |                      |          |
| 13.25             | Clearly defined instruction and authorisation procedures including a transaction trail for the movements of securities between custody and settlement areas. |                      |          |
| 13.26             | Clearly defined levels of access to central depository are established and reviewed on a regular basis.  |                      |          |
| 13.27             | Records of securities held are maintained by staff other than those processing physical movements.   |                      |          |
| 13.28             | Securities held in designated form (in name of trustees/stakeholder managers or their nominee) where this service is available and desired.                  |                      |          |
| 13.29             | Scheduled and frequent independent checks of securities held against control records should be evidenced.  |                      |          |

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 13.30             | Scheduled and frequent checks of safe custody records against independently maintained records and those of the investment managers should be evidenced.             |                      |          |
| 13.31             | Reconciliation of securities held with records of CREST should be evidenced.   |                      |          |
| 13.32             | Audits of securities, transactions and records are carried out by internal auditors, external auditors and regulators.   |                      |          |
| 13.33             | Client mandates are strictly observed. (Note that custodians can monitor but not stop trades or enforce mandates. Trustees may be able to stop trades).              |                      |          |
| 13.34             | Internal levels of authority for movements have been set and are strictly enforced.  |                      |          |
| 13.35             | All cash positions are reconciled daily.   |                      |          |
| 13.36             | Cash levels are monitored daily to ensure that funds are promptly invested.  |                      |          |
| 13.37             | Client cash is spread over a number of institutions.   |                      |          |
| 13.38             | A recognised information service is used so that income and other distributions can be anticipated and appropriate decisions can be taken on other corporate events. |                      |          |

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 13.39             | Dividends and interest are credited and made available to the client on payable dates.   |                      |          |
| 13.40             | Where appropriate prompt arrangements are made for currency conversion of foreign income.  |                      |          |
| 13.41             | Matters requiring action or decision are promptly communicated to the investment managers and/or trustees/stakeholder manager.   |                      |          |
| 13.42             | Controls are in place to ensure that all income from underwriting, stock lending, etc, is received.  |                      |          |
| 13.43             | Levels of authority for transactions have been defined and are strictly enforced. (Note that straight through processing (STP) will prevent the custodian from “touching” trades). |                      |          |
| 13.44             | Procedures ensure complete and accurate posting of instructions received.  |                      |          |
| 13.45             | Settlement differences are constantly monitored and investigated.  |                      |          |
| 13.46             | Procedures are in place to identify risks and changes in risks including counterparty risk.  |                      |          |
| 13.47             | Internal controls and procedures are reviewed in the light of any changes in risks identified.   |                      |          |

| POSSIBLE CONTROLS |  | Good = √<br>Weak = x | COMMENTS |
|-------------------|--|----------------------|----------|
| 13.48             | Instructions received from the client or investment managers are authenticated in accordance with the client agreement.  |                      |          |
| 13.49             | Stock lending and transactions in derivatives are carried out only in accordance with the trustees'/stakeholder managers' instructions.  |                      |          |
| 13.50             | There are procedures in place to ensure that particularly unusual transactions are referred back to the trustees/stakeholder manager.<br>(Alternative procedures will need to be in place if the custodian operates a Straight Through Processing (STP) system). |                      |          |
| 13.51             | There is an established system of internal checks to ensure adherence to clients' instructions with regard to areas of investment, authorities, etc.   |                      |          |
| 13.52             | Where stock lending is permitted, there is an established system for constant monitoring of collateral cover.  |                      |          |

## 14. SUB-CUSTODIAN NETWORK

| POSSIBLE CONTROLS |   | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|---|---------------------------------|----------|
| 14.1              | Markets are investigated in depth and risks carefully assessed before sub-custodians are appointed.   |                                 |          |
| 14.2              | Sub-custodians are selected on the basis of their integrity, credit rating and competence and not merely because they are “part of the group”.  |                                 |          |
| 14.3              | Initial appointments are based on the results of careful on-site scrutiny by staff of the principal custodian.  |                                 |          |
| 14.4              | Appointments are on the basis of agreements which clearly set out that securities are held as agents and are separate from the agent’s own assets and any other assets held by the agent. (Assets are “ring-fenced”). |                                 |          |
| 14.5              | There are frequent (at least monthly) reporting procedures by agents.   |                                 |          |
| 14.6              | Agents reports are reconciled promptly and differences are resolved.  |                                 |          |
| 14.7              | Quality control procedures are in use to ensure that standards are maintained. Agents are compared within markets and across markets.   |                                 |          |
| 14.8              | Agents are visited periodically by staff of the principal custodian to ensure adherence to the standards as stated in the service level agreements.   |                                 |          |
| 14.9              | Sub-custodian appointments are reviewed periodically.   |                                 |          |

| POSSIBLE CONTROLS |   | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|---|---------------------------------|----------|
| 14.10             | Collection of dividend and other entitlements is monitored independently by the principal custodian. Matters requiring action or decision are promptly communicated to the custodian. |                                 |          |
| 14.11             | Assistance is provided for the tax reclamation/relief at source.  |                                 |          |
| 14.12             | Cash is reconciled regularly with the custodian.  |                                 |          |
| 14.13             | There are procedures in place to ensure that if certificates are lost they can be speedily replaced.  |                                 |          |
| 14.14             | There are adequate safeguards to deal with the added risks arising from bearer markets.   |                                 |          |

## 15. TAXATION

| POSSIBLE CONTROLS |  | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|--|---------------------------------|----------|
| 15.1              | Tax laws, regulations and practices in the various markets are monitored on a formal basis.  |                                 |          |
| 15.2              | Taxation reclaim control accounts are automatically generated as part of the income collection function and outstanding positions reported and reconciled monthly. |                                 |          |
| 15.3              | Where possible, arrangements are agreed with the authorities to avoid deduction at source.   |                                 |          |
| 15.4              | The best available recovery periods are negotiated in each market.   |                                 |          |
| 15.5              | Claims are generated automatically and submitted promptly.   |                                 |          |
| 15.6              | Payment of claims is monitored and undue delays investigated.  |                                 |          |
| 15.7              | The custodian satisfies the requirements of the Inland Revenue for Qualified Intermediaries.   |                                 |          |

**16. REPORTING BY THE CUSTODIAN**

| POSSIBLE CONTROLS |   | Good = $\checkmark$<br>Weak = x | COMMENTS |
|-------------------|---|---------------------------------|----------|
| 16.1              | Timely reports are prepared and submitted to Trustees/managers in accordance with the terms of agreement  |                                 |          |
| 16.2              | Format and content of reports can be easily tailored to meet changing needs of the trustees/stakeholder manager.  |                                 |          |
| 16.3              | Reports consolidate all aspects of the: custody function: <ul style="list-style-type: none"> <li>• Securities</li> <li>• Cash</li> <li>• Income</li> <li>• Lending</li> <li>• Derivatives</li> <li>• UK and Foreign, etc</li> </ul>   |                                 |          |
| 16.4              | Custodian quality control monitoring reports are produced promptly in an easily understood form, with only key data being highlighted. These reports may include: <ul style="list-style-type: none"> <li>• Numbers of failed trades</li> <li>• Overdue income</li> <li>• Outstanding tax claims</li> <li>• Outstanding queries</li> </ul> |                                 |          |
| 16.5              | Investment performance reports are prepared and submitted to trustees/managers on a regular basis   |                                 |          |

