Draft regulatory strategy

Public service pension schemes

Ensuring high standards of governance
and administration in public service
pension schemes

December 2013

The Pensions
Regulator

Contents

Summary

1. Public service pension schemes form a significant part of the pensions landscape, providing pension benefits for around 12 million people.

2. In setting our strategic approach to regulating these schemes The Pensions Regulator is largely guided by the statutory objective to promote, and to improve understanding of, the good administration of pension schemes.

3. We will implement our strategy by understanding and assessing the risks to our objectives, defining our desired outcomes, deciding on the actions to be taken and determining when and where to intervene.

4. Our approach to the regulation of public service schemes is consistent with our normal approach in focusing on education and enablement. Where education and enablement fails to drive behaviour to the necessary standard we have a number of enforcement options available to us.

5. We will measure the impact of our activities on the regulated community and will keep our regulatory approach under review to ensure it remains appropriate and effective.

Introduction

6. This regulatory strategy sets out our approach to regulating public service pension schemes[1] pursuant to our statutory objectives.

7. Our approach to regulating work-based pensions sets out the overarching standards and principles by which we operate as an organisation.

8. Our current **Corporate Plan**[2] sets out, under this strategy, the objectives, key priorities and key performance indicators for the current business year in relation to public service schemes.

[1]
As defined in section 318 of the Pensions Act 2004.

[2]
www.tpr.gov.uk/plan

Background to this strategy

9. The Public Service Pensions Act 2013 (the 2013 Act)[3] sets out new arrangements for the creation of schemes for the payment of pensions (and other benefits). It enables the establishment of pension schemes for civil servants, the judiciary, local government workers, teachers, health service workers, fire and rescue workers, members of police forces, and the armed forces[4]. The 2013 Act recognises that the equivalent predecessor schemes will remain as legacy schemes, and provides for these schemes to be 'connected' to the new schemes (unless excluded) so that these and the new schemes can be governed, administered and regulated together.

10. For a number of other schemes, the largest being that of the United Kingdom Atomic Energy Authority, the 2013 Act requires the public authority responsible to close the scheme to future benefit accrual and to arrange for future service in one of the other new public service pension schemes or to create a replacement non-final salary scheme[5].

11. Schemes established under the 2013 Act and connected schemes are the public service schemes to which this strategy relates. Between them, the public service schemes provide pension benefits for around 12 million people. Public service schemes are established primarily as defined benefit (DB) schemes under which members are promised a level of benefit upon retirement usually determined by length of service and salary. The defined benefits under the new schemes will be calculated on a career average revalued earnings basis, whereas for service up to April 2015 (April 2014 for the schemes for local government workers) most are on a final salary basis.

12. Some public service schemes also enable members to join separate defined contribution (DC) schemes on an additional voluntary contribution basis.

13. The 2013 Act expanded our role in relation to public service schemes. In setting our strategic approach to regulating public service schemes we are guided by two of our five statutory objectives[6]:

    a. To protect the benefits of members of occupational pension schemes; and

    b. To promote, and to improve understanding of, the good administration of work-based pension schemes[7].

3
The Northern Ireland Assembly is currently considering draft legislation to make similar provision in respect of schemes for which they have legislative competence.

4
It is anticipated that these schemes will come into effect by April 2015 (April 2014 for local government workers), superseding existing schemes for service after that date.

5
See sections 30 and 31 of the 2013 Act.

6
See section 5(1) of the Pensions Act 2004.

7
Under section 5(3) of the Pensions Act 2004, a work-based pension scheme is: (a) an occupational pension scheme, (b) a personal pension scheme where there are direct payment arrangements, or (c) a stakeholder pension scheme.

14. These objectives shape our approach but we have discretion over how we achieve them. Given that the benefits in DB public service schemes are set out in legislation and are backed by the relevant public authority, it is not likely that the protection of member benefits will need to be a significant factor in our regulatory approach in relation to those schemes.

15. In relation to DC public service schemes the protection of member benefits will be relevant to our considerations (but we will take into account the degree of any element of public guarantee incorporated into individual scheme arrangements).

16. Irrespective of the kind of benefits due under a scheme, all public service schemes should be governed and administered in accordance with the requirements of the law. Across all public service schemes, governance and administration standards and practices impact upon the overall service provided to members (and other beneficiaries), including the payment of benefits. Good governance and administration should improve the efficiency of public service schemes and mean that they are more cost effective for employers, including the government departments responsible for the schemes.

17. We will therefore consider the risks that poor governance and administration standards and practices, and failures to operate schemes within the requirements of the law, present to public service schemes and how those risks may be mitigated by action to educate, enable and, where necessary, enforce.

Implementing our strategy

18. To implement our strategy we will:

    • understand risks across public service schemes

    • develop and communicate policies which set out good outcomes and what schemes should do

    • determine how best we can use our regulatory tools, from education to enforcement, to mitigate the risks we have identified and achieve our desired outcomes

    • decide on our priorities so that we target those schemes and issues which present the greatest risks and where we can make the most impact

    • apply our regulatory tools

    • measure the effectiveness of our policies and actions; and

    • continuously review and evolve our approach to make sure it remains effective.

Our strategy in action
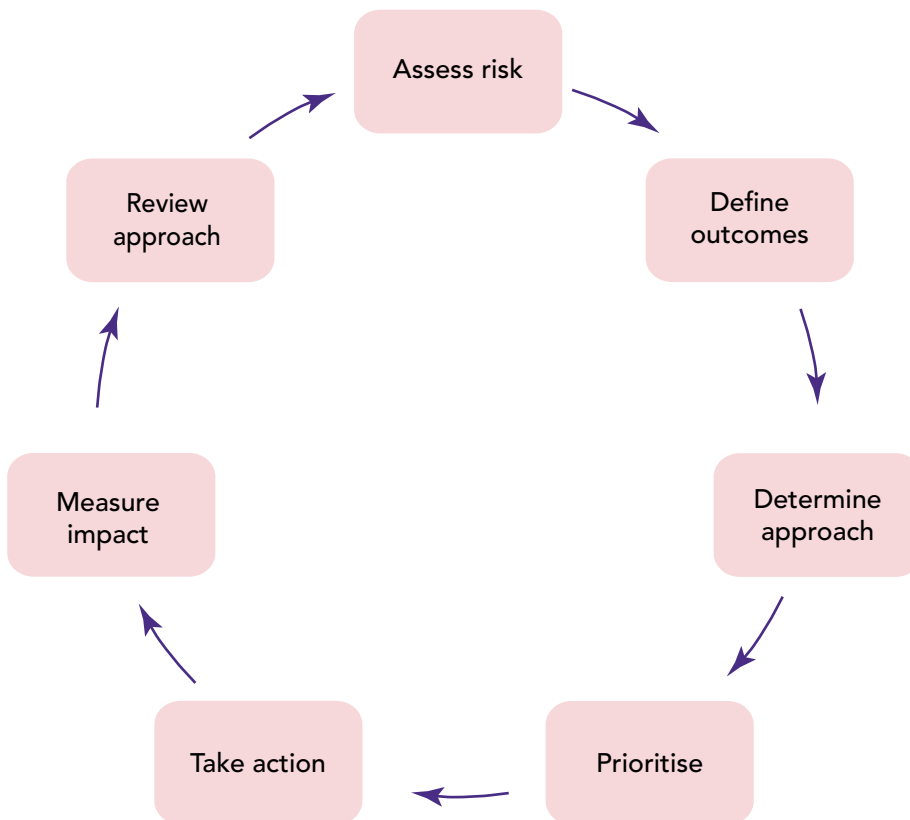
19. We aim to be transparent in our expectations and our actions. We will therefore publish policies and statements which set out the risks as we understand them, the desired outcomes and our intended approach.

20. We are keen to work in partnership with the regulated community to inform our understanding of risk as well as our policy and operational development. We will regularly engage with scheme managers, pension board members, employers, administrators and advisers to ensure that our policies are appropriate, relevant and well understood and that we are aware of sector themes, innovations and concerns. These steps, the outcome of our activities and the analysis of the impact of our approach feed into our policy development and risk assessment processes.

Assessing risk

21. A sound understanding of the risks in the system, in particular the risks that we can influence, is key to the success of our strategy and drives all our activities from policy development to the design of our operational processes.

22. We aim to consider risk both at macro and micro level to:

  • identify and assess emerging risks and trends proactively to inform our understanding of the public service schemes which in turn informs our policy and operational development

  • identify public service schemes (or other targets) for further consideration. We will do this proactively or reactively following reports and submissions made to us.

23. Our understanding of risks is informed by our experience of regulating other work-based pension schemes, data we collect on public service schemes and our assessment of how future developments could impact on their governance and administration arrangements. It relies on fit-for-purpose data which is timely, comprehensive, relevant and of good quality.

Areas of risk focus

24. As governance, the management of risks, administration and problem resolution influence the overall member outcomes, our consideration of risk across public service schemes focuses on elements from these areas. When undertaking a risk assessment the main areas we will consider are:

  • **Knowledge and understanding:** members of pension boards will need to be conversant with the regulations (or rules) and administration policies of their scheme and have the appropriate knowledge and understanding of pensions law to be able to assist their scheme manager effectively

  • **Records:** secondary legislation will specify the records required to be kept. The completeness and accuracy of these records will be key to the effective and efficient operation of schemes, including ensuring that the right benefit is paid to the right person at the right time. This will be supported by the operation of appropriate internal controls

  • **Member communication:** the quality of the information provided to members in terms of accuracy, timeliness and clarity is an important factor in achieving good member outcomes

- **Dealing with internal disputes:** public service schemes are usually large and complex and things will sometimes go wrong. The processes for investigating and resolving disputes quickly and effectively have a key role in contributing to the effective governance and administration of schemes.

25. Focusing on individual elements of risk in isolation is often a poor indicator of overall risk. In our risk assessment we consider risks in the round to inform our judgment as to whether further action is necessary.

Segmentation

26. To help understand and mitigate the risks across the various public service schemes we will identify whether particular schemes have similar characteristics (for example size, method of funding, or employer type) that are drivers of risk or have significant implications for the way schemes should behave. We will consider whether segmenting the regulated community by these characteristics can help us understand the issues and develop more effective and targeted policies and approaches for these segments.

27. The legislation requires public service schemes to be governed and administered according to a common framework of requirements so many of the issues will apply across the whole regulated community. However, we recognise that for other aspects our strategy may need to be applied in different ways in relation to different sections/ segments. For example, we may consider the specific implications of schemes which are funded – such as those for local government workers and some public body schemes – separately from those which operate on a 'pay as you go' basis, or we may consider those schemes with participation by a large and diverse employer base separately from those with a single or few participating employers.

Setting policies

28. Having understood the risk presented we seek to define what our desired outcomes are. These may be universally applicable to all schemes or be different for different segments, subject to an individual public service scheme's or group of employers' circumstances. At the highest level this represents our policy for that particular risk or issue.

29. Our policies are principle-based and outcome-focused (rather than rule-based) because we believe that while compliance with the legal requirements is important, focusing on qualitative compliance promotes flexibility, encourages best practice and sector innovation and increases the likelihood of public service schemes delivering outcomes in line with the legal requirements and standards and conduct set out in the code.

Deciding our approach

30. We have a range of regulatory tools from education to enablement to enforcement to achieve our policies. We describe how these are implemented below.

31. Our primary focus in public service schemes is to educate and enable those within the public sector to meet the legal requirements and the standards and practices we expect, but we will take enforcement action where necessary.

32. How we deploy our regulatory tools depends on the nature of those risks and how they can best addressed. For instance, a risk which poses a significant threat may potentially be mitigated by using all our tools while low risk issues may be mitigated principally by educational activities. While aiming for consistency, we also consider proportionality including the circumstances of any party subject to our actions and the likelihood and impact on them and other parties in deciding how to apply our regulatory tools.

Risk-based prioritisation

33. Our approach to understanding and taking action on risks is integrated. Therefore, while a public service scheme may come to our attention for a particular risk or issue, we look across all the risks to delivering good governance and administration to understand the overall risk and where action may have the greatest impact.

34. We use a wide range of information to assess risks posed by public service schemes and decide whether to act. However, we recognise the limitations inherent in data and intelligence collected, and, therefore, expert human judgment will play a central and key role in our decision-making.

35. Public service schemes cover a range of sizes from millions of members downwards but most are large schemes in the context of our scheme landscape. While we will target our resources towards the greatest overall risk, we will cover the complete regulated community in our broader activities. These will be in the form of targeted guidance, education campaigns and the promotion of identified good practice and warning of emerging risks and issues.

36. Identifying a public service scheme for further consideration does not imply that the scheme is non-compliant. Instead, based on the information we have, these schemes exhibit the greatest risks. Equally, where we receive information on a public service scheme and, having considered that information, decide not to take further action, this should not be interpreted as meaning that the scheme is necessarily compliant but rather that the level of risk does not meet our policy criteria.

Implementing our approach

Education and enablement

37. Scheme managers and pension boards will play the central role in ensuring that public service schemes are governed and administered effectively and that the right benefits are paid to the right people at the right time. We expect scheme managers and pension board members to carry out their roles competently and have sufficient skills, knowledge and understanding to be able to do so. We acknowledge the complexity of their roles and the fast-changing and challenging conditions facing them and employers alike.

38. In view of this complexity we place great emphasis on education and believe this is the most efficient means to reach those involved in the governance and administration of public service schemes. We rely on scheme managers, pension boards and employers to work together and we will provide guidance and support to help them do so.

39. We will use our website to provide user-friendly guidance and support for scheme managers and pension board members. Our website will direct scheme managers and pension board members to resources including relevant codes, guidance, e-learning materials and policy statements.

40. Enabling is a means to target support to those specific public service schemes and their employers where risk is the greatest and where we consider we can have the most impact. We will do this through direct engagement with those schemes and employers.

Enforcement

41. Enforcement is usually an option when educating and enabling does not improve standards sufficiently. When considering enforcement action important factors include:

    a. the evidence

    b. the grounds for the use of powers

    c. the range of powers available

    d. whether action is reasonable and proportionate (for example, past conduct and mitigation steps); and

    e. the impact of action on the parties affected and the wider impact within the regulatory framework.

42. Generally the key focus of our activities will be to support and enable scheme managers and pension board members to deliver better standards and practices of governance and administration without having to resort to the use of our enforcement powers. However, we may go straight to enforcement action in those instances where, for example:

    • there is sufficient evidence of a breach

    • there is an immediate and material risk or it has already crystallised; and/or

    • the delay arising from going through the engagement process outlined above is considered likely to cause a material risk.

43. In addition to any action that we may take, including enforcement action, we may also refer matters to other regulatory bodies where appropriate.

Measuring impact

44. We primarily measure our impact against our statutory objectives. In our annual report we will report on the exercise of our functions in relation to public service schemes.

45. In addition, we will measure the progress of:

    • schemes' knowledge, understanding and compliance with pensions legislation

    • the effectiveness of the regulatory tools we have provided and the extent to which we have influenced change using information from actions such as our thematic reviews and governance survey

    • the results of each activity we undertake, for example through education campaigns, thematic reviews or individual cases.

46. We will keep our regulatory approach under review to ensure that it remains effective, informed by our assessment of impact and our ongoing engagement with the regulated community.

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