

Regulatory strategy

Public service pension schemes

Regulating governance and administration
in public service pension schemes

January 2015

The Pensions
Regulator

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Introduction

1. This strategy sets out our approach to regulating public service pension schemes¹ in line with our statutory objectives.
2. Our regulatory approach to regulating work-based pensions is set out on our website² and describes the overarching standards and principles by which we operate as an organisation.
3. Our Corporate Plan³ sets out, in light of our regulatory approach, the objectives, key priorities and key performance indicators for the current business year that relate to public service schemes.

Schemes covered by this strategy

4. The Public Service Pensions Act 2013 and the Public Service Pensions Act (Northern Ireland) 2014 (the Public Service Pensions Acts) set out new arrangements for the creation of schemes for the payment of pensions (and other benefits). They enable 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. These schemes are expected to come into effect by April 2015 (April 2014 for local government workers in England and Wales), superseding existing schemes for service after that date.
5. The Public Service Pensions Acts recognise that the equivalent predecessor schemes will remain as legacy schemes. These schemes will be 'connected' to the new schemes (unless excluded) so that they are all governed, administered and regulated together.
6. For a number of other schemes, the largest being that of the United Kingdom Atomic Energy Authority, the Public Service Pensions Acts require 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 scheme⁴.
7. This strategy relates to schemes established under section/Article 1 of the Public Service Pensions Acts, new public body pension schemes and connected schemes.
8. Between them, the public service schemes provide pension benefits for around 13 million members. Public service schemes are established primarily as defined benefit 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 (CARE) basis, whereas for service up to April 2015 (April 2014 for the scheme for local government workers in England and Wales) most are on a final salary basis.

1
As defined in section 318 of the Pensions Act 2004 and Article 2 of the Pensions (Northern Ireland) Order 2005.

2
www.tpr.gov.uk/regulate

3
www.tpr.gov.uk/plan

4
See s31 of the Public Service Pensions Act 2013 and s32 of the Public Service Pensions Act (Northern Ireland) 2014.

9. Some public service schemes also enable members to join separate defined contribution schemes including additional voluntary contribution schemes.

Our strategic aims for regulating public service schemes

10. The Public Service Pensions Acts expand our role in relation to public service schemes and were enacted in response to the final report of the Independent Public Service Pensions Commission published in 2011 and the Treasury paper Public Service Pensions: good pensions that last (November 2011). The Commission's report recommended scheme redesign, reform and regulation, with a view to balancing the interests of taxpayers, employers and members. The legislative reforms are intended to reduce and control scheme costs and the Acts require schemes to be created according to a common framework of requirements.
11. The Public Service Pensions Acts also provide for a clearer governance structure with specific defined roles, the publication of information on a consistent basis, and administration requirements broadly in line with those in the private sector. Our role is to regulate public service schemes in relation to the governance and administration requirements introduced by the Acts.
12. In setting our strategic aims for regulating public service schemes, we are primarily guided by two of our five statutory objectives⁵:
 - to protect the benefits of members of occupational pension schemes, and
 - to promote, and to improve understanding of, the good administration of work-based pension schemes⁶.
13. All public service schemes must be governed and administered in accordance with the requirements of the law. We recognise that governance and administration standards and practices impact upon the overall service provided to members (and other beneficiaries) throughout their membership, including the payment of benefits. In addition, establishing and implementing effective governance and administration frameworks will 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.

5

See section 5(1) of the Pensions Act 2004 and Article 4 of the Pensions (Northern Ireland) Order 2005.

6

Under section 5(3) of the Pensions Act 2004 and Article 4(3) of the Pensions (Northern Ireland) Order 2005 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. We further recognise that these schemes face a significant task in implementing the major reform of their benefit design, establishing new governance arrangements and putting in place systems to deal with the administration of the new and transitional arrangements while maintaining and integrating their legacy systems. By their nature – their size and, in some schemes, the number and variety of employers participating in the scheme – the schemes are subject to major challenges, for example, in achieving and maintaining high quality records⁷.
15. Therefore, our aims in relation to the regulation of public service pension schemes are:
 - a. to understand governance and administration practices within public service schemes and make clear the standards and practices that are expected
 - b. to improve governance and administration standards and practices across all schemes, and
 - c. to support those responsible for complying with legal requirements so that those requirements are met.
16. In considering where to focus our resources on improving standards we will initially concentrate on the risks that we have identified as posing the greatest threats to the effective governance and administration of public service schemes and legal requirements not being met, as well as the protection of member benefits where relevant. We will consider how we can mitigate these risks by taking action to educate and enable and, where necessary, enforce compliance with legal requirements.

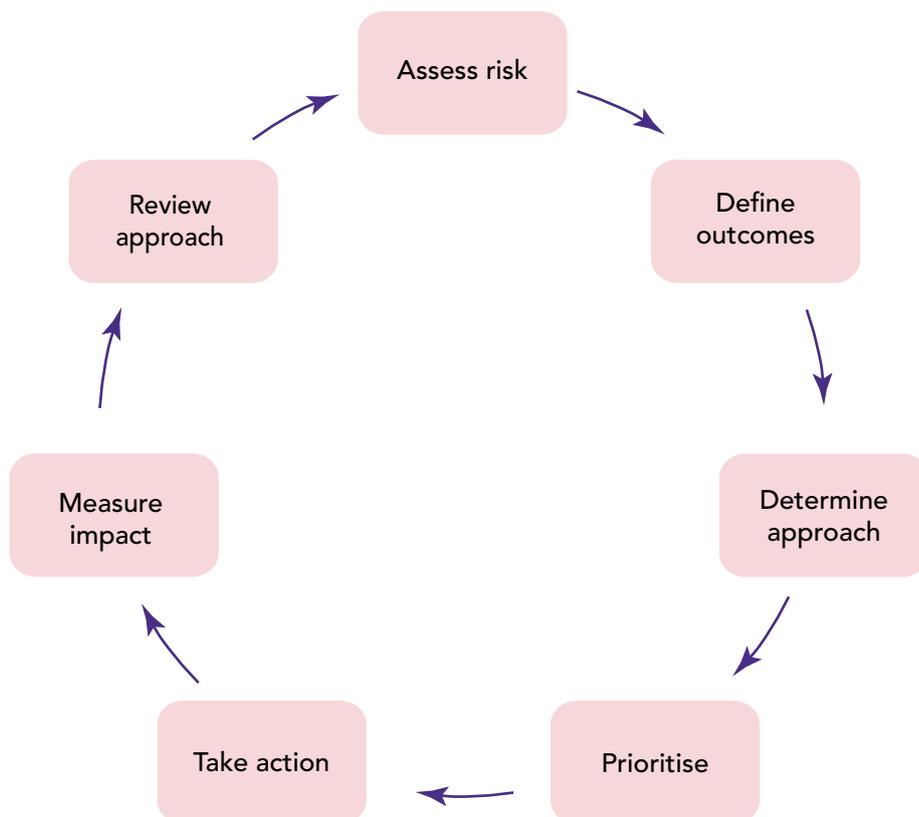
7
Public service pension schemes: A summary of governance and administration, The Pensions Regulator, September 2013.

Our strategy

17. Our strategy for regulating public service schemes is to:

- 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 have 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



18. We are 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.
19. We will regularly engage with scheme managers and pension board members, and where applicable employers, administrators, advisers and scheme advisory boards to:
 - inform our understanding of themes, innovations and risks across public service schemes and
 - ensure that our policies are appropriate, relevant and well understood.

Assess risk

20. A sound understanding of the risks relating to public service schemes, and in particular the risks that we can influence, is key to the success of our strategy. This drives all our activities from developing policies to designing our operational processes.
21. We will:
 - proactively identify and assess emerging risks and trends to inform our understanding of the public service schemes, and
 - identify public service schemes for further consideration, either proactively or reactively, following reports and submissions made to us.
22. 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

23. As governance, risk management, conflicts of interest, administration and matters raised for dispute resolution influence overall member outcomes in public service schemes, we will focus on risks in the following areas when considering risks across public service schemes:
 - **Knowledge and understanding:** members of pension boards must comply with the requirement to have the appropriate knowledge and understanding to be able to assist their scheme manager effectively. Failure to do so is a breach of law.

- **Conflicts of interest:** scheme managers must ensure that pension board members do not have any conflicts of interest. A failure to do so is a breach of the law and could, for example, result in the advice and/or decisions of the pension board being open to challenge and, ultimately, the ineffective governance of the scheme
 - **Records:** legislation specifies the records that must be kept and failure to comply is a breach of the law. 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 operating appropriate internal controls
 - **Internal controls:** scheme managers must establish and operate internal controls. Failure to comply with this requirement is a breach of the law and it may also result in schemes not being run in accordance with the law and/or risks not being identified, mitigated and managed properly
 - **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. Failure to comply with disclosure requirements is a breach of the law and may indicate incomplete or inaccurate record-keeping and/or inadequate internal controls
 - **Dealing with internal disputes:** where we become aware of matters that are raised under internal dispute resolution procedures, this can be an indicator of wider systemic issues which may impact the effective governance and administration of schemes.
24. Focusing on individual elements of risk in isolation may give a poor indication of overall risk. In our risk assessment we will consider risks in the round to inform our judgment as to what, if any, action is necessary.

Segmentation

25. 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 of membership, method of funding or employer type) that are drivers of risk or have significant implications for the way that those involved in the governance and administration of public service 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.

26. The legislative framework 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 segments. For example, we may consider the specific implications of schemes which are funded – such as those for local government workers – 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.

Define policy outcomes

27. Our approach will be principle-based and outcome-focused, rather than prescriptive. While we expect compliance with the legal requirements, we believe that focusing on the substance of issues promotes flexibility and innovation, and encourages adoption of best practice. This should increase the likelihood of public service schemes delivering outcomes that satisfy the legal requirements, as well as the standards of conduct and practice set out in our code of practice.
28. Having understood the risks relating to public service schemes, we will define our desired policy outcomes with our statutory objectives in mind. These outcomes may be applicable to all schemes or may only apply to some. For example, different outcomes may be defined according to the nature of the scheme, an individual scheme’s circumstances or the circumstances of a group of employers.

Determine our approach

29. Our approach to regulating public service schemes is consistent with our overall operational approach to educate and enable and, where necessary enforce compliance. We will focus our activity on those involved in the governance and administration of public service schemes so that legal requirements are complied with, as well as increasing the likelihood that the standards and practices we expect are met.
30. Our regulatory approach will depend on the nature of the risks we have identified and how they can be best addressed. For instance, a risk which poses a significant threat may potentially be mitigated by a range of education, enablement and enforcement activities while low risk issues may be mitigated principally by educational activities. At the highest level this represents our policy to address that particular risk or issue.
31. We will be consistent and proportionate in considering the circumstances of any party subject to our actions and the likely impact on them and other parties in deciding our approach.

Prioritise using a risk-based approach

32. We will take an integrated approach to understanding and taking action on risks. Therefore, while a public service scheme may come to our attention for a particular risk or issue, we will look across all the risks to delivering good governance and administration to understand the overall risk and where action may have the greatest impact.
33. We will use a wide range of information to assess risks to public service schemes and decide what action may be appropriate. However, we recognise the limitations inherent in the data and intelligence we collect. Therefore, we will exercise discretion in accordance with good regulatory practice, with operational judgement playing a central role in our decision making.
34. Public service schemes cover a range of sizes from millions of members downwards but most are large schemes in the context of our overall scheme landscape. While we will target our resources towards the greatest overall risks we see in relation to public service schemes, we will nevertheless engage with all public service schemes in our broader activities. This will include targeted educational guidance and the identification of good practice and risks.
35. Identifying a public service scheme for further consideration does not imply that legal requirements are not being complied with but indicates that we consider the scheme to exhibit greater risks based on the information we have. Equally, where having considered information about a public service scheme we decide not to take further action, this should not be interpreted as meaning that legal requirements are being complied with, but rather that the level of risk does not meet our risk bar.

Take action

Education and enablement

36. 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, as well as all others involved with the governance and administration of public service schemes, to carry out their roles competently and have sufficient skills, knowledge and understanding to be able to do so.

37. In view of this, 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.
38. 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.
39. Enablement is a means to target support to those specific public service schemes 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.

Enforcement

40. Generally the main focus of our activities will be to support and enable scheme managers, assisted by 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 will consider enforcement action when educating and enabling does not lead to satisfactory outcomes. When considering enforcement action, important factors include:
 - the evidence
 - the grounds for the use of powers
 - the range of powers available
 - whether action is reasonable and proportionate, for example past conduct and mitigation steps, and
 - the impact of action on the parties affected and the wider impact within the regulatory framework.
41. However, in certain circumstances we may go straight to enforcement action, for example:
 - where there is sufficient evidence of a breach
 - where there is an immediate and materially significant risk or it has already crystallised, or
 - the delay that would arise from going through the engagement process outlined above is considered likely to cause a material risk.
42. In addition to any action that we may take, including enforcement action, we may also refer matters to other regulatory bodies where appropriate.

Measure the impact

43. 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.
44. Using information gathered by methods such as surveys, scheme engagements, thematic reviews, annual research, individual scheme investigations and whistleblowing reports, we will measure:
 - the progress of scheme managers' and pension board members' compliance with legal requirements
 - the effectiveness of education and enablement tools we have provided and the extent to which we have influenced change, and
 - the results of each regulatory activity we have undertaken.

Review our approach

45. 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, and feedback from, the regulated community.

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