Regulating public service pensions

RESPONSE FROM ICAS TO THE PENSIONS REGULATOR

21 February 2014
Introduction
The ICAS Pensions Committee welcomes the opportunity to comment on The Pensions Regulator’s (TPR’s) consultation on regulating public service pension schemes.

Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public and charity sectors.

Our Charter requires ICAS committees to act primarily in the public interest and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members’ views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount. For example, the ICAS Pensions Committee has published two high profile reports on pensions in an independent Scotland in the context of the Referendum debate. Our reports which have been published under the banner “Scotland’s pensions future” have successfully raised important issues on the implications of independence for the State pension, public sector pensions and private pensions.

Key points
We have the following key points to raise on the draft code:

- The proposed strategy and code do not deliver a clearer vision for the regulation of public service pension schemes. We recommend that plans for regulating public service schemes begin with a clear articulation of principles, which is the approach followed in TPR’s recent consultation on the strategy, regulatory approach and code for funding defined benefits.
- For funded public service schemes, there needs to be greater alignment with the proposed code on funding defined benefits, including the approach to the four risk areas identified in the code of funding defined benefits.
- The role of the pension board for public service schemes is very unclear. This issue appears to arise from the drafting of the Pensions Act 2013. However, unless the role of the pension board can be made clear through the development of regulations which apply across all public service schemes, the governance of schemes may not be effective. The main issue to be resolved is whether the role of the pension board is genuinely advisory or whether it has a governance role.
- The intention to make the code a one stop shop for public service schemes does not appear to have been achieved. Guidance incorporated from other codes had not been included in full and therefore we recommend that cross-references to other codes are included in the public service scheme code as appropriate.
- As there is no statutory duty for TPR to minimise the impact of regulation on the sustainable growth of the employer or a public service equivalent, there is a potential gap in the regulatory regime. TPR should at least be obliged to have regard to the cost implications for public service employers and other employers participating in public service schemes, e.g. charities, of its regulatory requirements. This current omission may place the admitted bodies of local government schemes at a disadvantage relative to other organisations which participate in private sector multi-employer defined benefit schemes.

Our responses to the individual consultation questions are set out below.

Any enquiries should be addressed to Christine Scott, Assistant Director, Charities and Pensions, at cscott@icas.org.uk.
Consultation questions

Question 1
Does the code sufficiently address the standards of conduct and practice necessary to evidence compliance with pensions legislation? If not, why not? What improvements would you recommend?

Answer 1
We have not undertaken a detailed comparison of the code and pensions law and therefore cannot provide a definitive answer. However, we would not expect pension board members to rely solely on the code as a means of understanding pensions law and therefore we support the requirement in paragraph 33 which states that “A member of the pension board must have knowledge and understanding of the law relating to pensions.” We would also expect the scheme manager to be conversant with pensions law to a higher degree than members of the pension board but there does not appear to be a specific statement to this effect in the draft code.

As an accountancy body, we would like to see legislative references in the code to the relevant requirements for the preparation of annual report accounts and audit placed on public service schemes. The preparation of an annual report and accounts and the auditor’s report are a means for schemes to demonstrate how the funds have been stewarded.

Question 2
Does the level of guidance included in the code provide sufficient detail to enable scheme managers and members of pension boards to comply with pensions legislation and undertake their role effectively?

Answer 2
By incorporating material from other codes within this code, it appears to be designed as a one stop shop. However, this has not been achieved on two levels:

- First, it fails to articulate any real vision for public service schemes around good governance and effective stewardship and this could encourage a tick box approach by the pension board.
- Second, it does not actually incorporate all relevant material from other codes, for example, we do not think that all relevant material from code of practice 9 on internal controls has been replicated.

Good governance and stewardship
We believe that the role of the scheme manager and pension board is not sufficiently clear in the Pensions Act 2013 and this has given rise to weaknesses in the draft code. The stated role of the board in the Act is to advise the scheme manager but a governance role is implied by the code. This matter needs to be resolved or members of pension boards will be unclear about their role and this could ultimately hinder the good governance of schemes.

The role of private sector trustee boards is clear from legislation (the Trustees Act). However, it is not clear what the statutory or fiduciary duties of the scheme manager (as defined in the 2013 Act) are. For a local government pension scheme, in the context of the 2013 Act, the pensions committee is effectively the scheme manager or the equivalent of a private sector trustee board. Private sector trustee boards operate without the equivalent of a pensions board and without this read across or a clear vision of the role of the pensions board it is difficult to see how such a board would add value. If pension boards are to be established, we believe it would be preferable for their role to be set out in detail in regulations to ensure that a consistent approach is established across public service schemes.

Our understanding of a typical pre-2013 Act structure for the governance and management arrangements of a local government schemes is as follows:

- There is a scheme manager who is usually the head of the in-house pensions team.
- There is a pensions committee (described as the scheme manager in the 2013 Act) formed of elected members (i.e. councillors) who are subject to appointment or reappointment annually.
- Most schemes have an investment sub-committee which may invite external stakeholders, for example, trade union and employer representatives, to attend but without voting rights.
- Advisors may be in attendance at meetings but their appointments do not appear to be regulated in the same way as other regulated schemes.
Following from our present understanding, there are obvious differences between these arrangements and the arrangements of other regulated schemes. Elected members represent the interests of scheme members but also local authority interests. There is no equivalent of the member nominated trustee, for example, as trade union representatives do not have voting rights. If existing structures evolve with a view to complying with the requirements of the 2013 Act, there will clearly be conflicts of interest which need to be managed. We make further comment on conflicts of interest in our response to question 8.

We believe that the TPR should set out its key principles for the regulation of public service schemes. We envisage that this would include a core set of principles for all schemes with additional principles to accommodate funded schemes.

There should be a greater emphasis on efficient and effective governance, management and administration. Member outcomes are referenced in the consultation documents but the code does not articulate what good member outcomes are in the context of public service schemes nor is there any discussion around minimising the costs associated with governance, management and administration.

In respect of public service schemes which are funded, we believe that a regulatory strategy and approach consistent with private sector defined benefit schemes should be followed to a large extent, albeit we have raised a number of concerns in our response to TPR, dated 7 February 2014, on the regulation of defined benefit pensions.

We would support an integrated risk management approach by funded public service schemes towards the four broad risk areas of:

- Employer covenant-related
- Investment-related
- Funding-related
- Governance-related

We recognise that employer covenant-related risk may be of a lower order relative to the private sector. However, local government schemes are not underwritten by central government so this should not be ignored. Covenant-related risk is also relevant to the admitted bodies of local government schemes not just the administering authority.

The code appears to have been prepared without consideration of other material which has been developed on governance and stewardship. For example, the Charity Commission has produced good quality guidance on risk management for charity trustees. It is also important to recognise that risk management arrangements should include the consideration of opportunities. In addition, we recommend that the material on risk management in the code on funding defined benefits is adapted for the public service pension schemes code.

Material from other codes
Given that material from other codes which is relevant has not been incorporated wholesale, we would like to see cross-references to these codes included within this draft code.

Question 3
The code relates only to the specific matters on which we are required to issue a code under section 90A(2) of the Pensions Act 2004. Are there any other legal requirements which you think should be brought within the scope of the code? Are there parts of the code which you think go beyond legal requirements, practical guidance and good practice?

Answer 3
In our answer to questions 1 and 2 we raise a number of overarching issues on the preparation of the code. In addition, there appears to be a further weakness in the proposals, as there is no duty placed on TPR equivalent to its new duty, in relation to private sector defined benefit schemes, to minimise any adverse impact on the sustainable growth of the employer.
We are aware that concerns have been raised by other commentators, in their responses to TPR's proposals on the regulation of defined benefit schemes, about how those proposals could impact on not-for-profit sector participants in multi-employer last man standing schemes. However, there is at least the possibility of amending TPR's approach to take into account the cost pressures on such organisations. However, with regard to public service schemes, there is no equivalent duty. We recommend that TPR's regulatory strategy towards funded public service schemes should include consideration of the impact of regulatory activity on the sustainability of organisations admitted to local government pensions schemes which are not-for-profit.

Question 4
Have we targeted the code and the right groups of people? If not, which have been overlooked?

Answer 4
We believe that a list of key stakeholders who may find it useful to understand the code should be drawn up. This is the approach taken in code of practice 3 on funding defined benefits.

Question 5
Is there any further information of explanation you would like to see in the “terms used” section of the introduction?

Answer 5
We have no additional comments to make on this section of the code.

Question 6
Does the code strike the right balance between being as concise as possible and providing enough practical guidance relating to the underlying legal obligations?

Answer 6
This is another lengthy document from TPR and, once in final form, we would recommend that a more focused quick guide is produced as a companion document.

Question 7
Do we adequately describe the level of knowledge and understanding required of members of pension board? If not, why not?

Answer 7
In our response to question 2, we highlight our concerns that the role of the pension board is not clear therefore it is not currently possible to make an assessment in this regard.

Question 8
Does the practical guidance adequately address the risks of the different types of conflicts of interest which may occur? Could you provide better examples of key conflicts which should be provided in the code?

Answer 8
We are concerned about how conflicts of interest with regard to pension board members are addressed in the code. Paragraph 63 suggests that conflicts of interest cannot be managed: we do not agree with this assertion. It is likely, that with a pension board consisting of employer and employee representatives, that actual conflicts of interest will exist and will need to be managed.

We also recommend that guidance on conflicts of interest is drafted to consider conflicts in relation to the close family of board members. Under company law and accounting standards, members of a director’s close family are deemed to be related parties meaning that transactions between the company and a member of a director’s close family must be disclosed in the company’s accounts. Therefore, it would seem reasonable to consider conflicts of interest in a wider sense by extending the examples given to cover pension board members and their close family.

In respect of bodies admitted to local government schemes, we believe that the code should introduce safeguards to ensure that the interests of admitted bodies and their employees, former employees and retired members are given sufficient regard. Therefore, we envisage that it will be essential to have admitted body representation on the pension board sufficient to balance the interests of admitted bodies with those of the administering authority. This approach should assist in the management of conflicts of interest.
**Question 9**
Does the practical guide in the code sufficiently capture all of the duties, including fiduciary duties owed by pension board members? Do you consider that such duties may arise in the context of public service schemes? Please explain your response.

**Answer 9**
We believe that the role of the pension board is unclear and therefore it is not possible to provide an answer to this question.

**Question 10**
Have we set out clearly what actions are expected of scheme managers and members of pensions boards in relation to risk management and internal controls?

**Answer 10**
In our response to question 2, we set out our views on weaknesses in the code’s approach to risk management. The draft code places a significant degree of emphasis on internal controls and managing risks of scheme in the context of scheme administration but there is no emphasis on external risks such as investment-risk including the custody of assets.

With regard to the detailed guidance on internal controls, the material seems to be much shorter than the original code on internal controls. Therefore, in our response to question 2, we recommend that a cross-reference is given to the original code.

We have the following detailed comments on the material on internal controls:

- Paragraph 102 talks about schemes reviewing their existing arrangements and procedures to determine whether they can prevent and detect errors in scheme operations and help mitigate pension scheme-related risks. However, we question whether “reviewing” arrangements and procedures would give the desired level of assurance that controls and procedures are working effectively. Therefore, we believe that the draft code should focus on determining how you obtain the assurance needed which could be through direct testing, obtaining timely reports on controls etc. The question is would pension boards know how to obtain the correct level of assurance? This may not be the case and therefore more guidance on this may be required.

- Paragraph 104 refers to designing internal controls to manage risk. Again, we are not sure that the examples set out are necessarily the most appropriate (and seem to have been lifted from the DC code). For example, there is no mention of fundamental internal controls such as segregation of duties or controls around approvals and authorisations. For schemes which are administered in-house, these types of controls are even more important.

- Paragraph 111 is very focussed on the outsourcing of administration and obtaining evidence of how operations are controlled through independent assurance reports. These can only go so far and may not even cover controls specific to the scheme in question so it is vital to ensure that the pension board is getting sufficient assurance that information provided to the board is detailed enough and that service level agreements cover all the right areas. By contrast, there does not appear to be anything on outsourced investment management services which would have a much bigger impact on liabilities if there were control weaknesses around the safe custody of assets.

**Question 11**
Does the public service code include sufficient practical guidance on the standards of administration that we expect? Are there any parts of the code that you think are too prescriptive?

**Question 11**
Our response to question 2 sets out our views on the approach taken to the draft code. Again, this whole section is very much focused on administration of benefits and members and has nothing really on investments, investment income, cash flows etc.
We also have the following detailed comments on the topic of administration:

- Paragraph 128 refers to the requirement in the draft record keeping regulations that records are kept for six years, by DB schemes, after entitlement to benefits ceases. We understand that for last man standing schemes, records must be kept until the scheme is dissolved. We recommend that these draft regulations are amended and/or the Code is updated, as necessary, to reflect this.

- Paragraph 131 says that schemes should continually review their data and carry out a “full data review” exercise at least annually. It would be helpful to know what this is expected to mean as this could be a significant undertaking and may not be proportionate to the associated level of risk and hence the cost versus the benefit of such an undertaking.

- Paragraphs 131 to 133 set out TPR’s expectations for an annual data review exercise. However, guidance in this area has been shortened relative to the guidance which has been developed for other regulated schemes and does not develop the standards for common and conditional data.

**Question 12**
We provide examples of what failures to pay contributions are likely to be materially significant to the regulator. Are there any other examples or scenarios that should be included?

**Answer 12**
We have no specific comments to raise on this aspect of the draft code.

**Question 13**
Have we made clear the circumstances under which breaches of pensions legislation should be reported to us?

**Answer 13**
We have no specific comments to raise on this aspect of the draft code.

**Question 14**
Does the strategy, together with the public service code, sufficiently address risks to good governance and administration?

**Answer 14**
Our main comments on the strategy and the code are set out in our responses to questions 1 to 3.

**Question 15**
Does the strategy explain adequately the approach we will take in regulating public service schemes?

**Answer 15**
We believe that further work is needed to develop the strategy towards public service schemes which draws on TPR’s experience and approach to the regulation of private sector schemes. In particular we believe that the approach to the regulation of funded public service schemes should draw on TPR's approach to the funding of private sector defined benefit schemes.

**Question 16**
The impact assessment undertaken by the Treasury concluded that the new governance, administration and regulatory oversight provisions should not result in additional costs for schemes. The code gives practical guidance and standards of conduct and practice in relation to those new provisions. Do you agree that the public service code and public service regulatory strategy do not place an additional regulatory burden on schemes? If you do not agree, please explain and quantify additional costs.

**Answer 16**
We believe that there could be significant costs incurred to educate pension board members.

A revised impact assessment would be required in the event that TPR is minded to take on board our suggestions for developing a strategy towards public service schemes which better reflects existing private sector practice.