The Governance of Work-based Pensions Schemes
A Discussion Paper from The Pensions Regulator

A response by

The National Association of Pension Funds
July 2007

SECTION ONE - INTRODUCTION

1. The National Association of Pension Funds (NAPF) welcomes the opportunity to respond to the discussion paper – *The governance of work-based pension schemes*.

2. We support the drive for good governance, provided it does not add to the regulatory burden. The NAPF believe it is important to seek consensus on finding the right balance between member protection and encouraging employer provision. This paper restates the NAPF's key priorities for good governance on which we place considerable value.

3. The NAPF is the leading voice of workplace pensions in the UK. Our 1300 members provide pensions on behalf of more than 15 million people and have combined assets of around £800 billion.

SECTION TWO – GENERAL COMMENTS

4. Good pension scheme governance is too important to ignore, and the NAPF is pleased that the Pensions Regulator (TPR) is fully aware of this. It will also be aware that the NAPF puts considerable store by high quality governance. It is a system that has served millions of pension scheme members well. Good governance ensures that members' interests are well served (delivers on-going value for money); and provides an effective mechanism to monitor performance and oversee the quality of the providers on behalf of the members.

5. Whilst the NAPF fully supports the need for good governance, it is important that the Pensions Regulator takes a "light touch" approach and does not add to the already heavy burden of regulation.

6. Overall we endorse TPR's medium term strategy which states that "the desired longer term outcome is to have well informed, capable trustees acting in the best interest of their members". [1] The NAPF also supports the use of Pensions Management Committees, in cases where the employer offers a GPP or a Stakeholder pension. Provided appropriate safe-guards are in place for the

[1] The Pensions Regulator, *Medium Term Strategy*, April 2006, page 40

sponsoring employer. We are pleased that the Regulator has said it will provide guidance for employers wishing to set up such bodies on a voluntary basis.

7. Our response makes a number of comments and recommendations, these are outlined in summary below:

   a. The NAPF supports improved governance but not via increasing the burden on trustees or the pressure on employers offering occupational pension schemes;
   b. We support the use of management committees, on a voluntary basis, for GPPs and Stakeholder schemes;
   c. Care must be taken to avoid TKU requirements from becoming too onerous;
   d. Consider the option of allowing the board as a whole to meet the requirement of TKU rather than each individual trustee;
   e. Consider the possibility of consolidating smaller schemes in to master trusts to help address governance issues;
   f. The regulatory regime should balance the requirements on trustees with those on scheme advisers;
   g. The NAPF suggests TPR should provide specific guidance on helping trustees monitor the employer covenant;
   h. We suggest TPR work with trustees to ensure they get the best from their advisers.
   i. The NAPF welcome TPR's approach to promoting and sharing good administration practices;
   j. TPR should look at the Myners principles in addressing investment matters in light of the NAPF's review. (The NAPF would be pleased to provide early information on the results emerging.)

SECTION THREE – NAPF COMMENTS ON SPECIFIC QUESTIONS

Question 1. Is the Pensions Regulator right to place importance on the governance of pension schemes?

8. The NAPF has consistently sought to promote good governance of pension schemes though guidance documents, training and policy initiatives. In July 2005 we published a Discussion Paper, "Pension Scheme Governance – fit for the 21st Century?" which set out some of the key challenges faced by pension schemes related to governance and made a number of recommendations. The NAPF continues to regard governance as a priority and so welcomes the Regulator's prioritisation of this issue.

9. However, there is a danger that the Regulator's current approach places a little too much emphasis on the knowledge and understanding of trustees rather than on other means of improving governance, such as promoting the consolidation of small schemes (see "Super Trusts – putting members first", NAPF) and ensuring that

scheme advisers bear greater responsibility for their advice to trustees. Care must be taken not to overburden trustees.

10. Whilst the paper addresses the issue of contract-based schemes, it remains unclear on how the regulation and governance of such schemes will be addressed in light of the dual role of the FSA and TPR in this regard.

Question 2. Do you agree with the determinants of our regulatory priorities set out in paragraph 3.7? These are:

• the regulator's existing approaches to governance;

11. The NAPF agree with much of the work already done in this area, however, we do have some concerns around the requirements of the TKU programme and whether it is fit for purpose. With this in mind, we think there is scope to look again at some of the Regulator's existing approaches to governance in terms of requirements on trustees. A key issue for schemes is stability, therefore, we would not support any proposals that are likely to increase the pressures on trust-based pension schemes.

• evidence of how schemes are governed;

12. We support the intention that TKU's regulatory approach to governance be evidence based, and that any regulatory intervention be based on evidence of a risk or potential risk to the statutory objectives.

13. We welcome the Regulator's recognition that governance standards and practice varies between small and large schemes, DC and DB schemes, and in contract-based compared to trust-based schemes. We suggest that the Regulator may need to take targeted activity in each case.

• recent and forthcoming developments in the pensions environment

14. We think it is right that the Regulator uses information from recent and future developments in the pensions environment to help identify regulatory priorities. The key environmental issues for consideration should include:

    a. changes within the world of workplace provision, for example, the shift from DB to DC and the growing tendency for new schemes to be contract-based rather than trust-based;
    b. changes to the regulatory environment, especially, initiatives such as the Myners Review from other governmental bodies.

• our approach to regulation.

15. Using a risk based approach to regulation, alongside the Regulator's tools to educate and enable as well as enforce, should provide a sensible and measured approach to regulation. Though it is important to keep in mind any different approaches to regulation being used by the FSA, especially where there is some overlap with TPR regulation.

Question 3. Do you agree with our regulatory priorities?

Knowledge and understanding of the governing body
Knowledge and understanding

16. We support TPR's drive to improve scheme governance and increase member confidence in work-based pensions. We agree that knowledge and understanding of the governing body should be a priority for TPR.

17. However, the NAPF has a number of concerns around the impact of the TKU requirements, and whilst we acknowledge that there is a clear link between good knowledge and standards of governance, we think some of the requirements set out in the TKU are perhaps more detailed than necessary. The NAPF supports the need to ensure that trustees have opportunities to increase their knowledge base but the regulatory regime should ensure that such requirements are balanced fairly between trustees and their professional advisers.

18. One of the key issues that needs to be addressed is the requirement for all trustee board members to have the same level of knowledge and understanding, this we feel, is perhaps too onerous and needs reviewing. We are not certain that the TPR is right to expect ALL trustees to individually understand ALL the TKU requirements. There are other approaches. For example, in the case of private companies, it is the board as a collective whole that is required to ensure that the company is well-governed. Perhaps the TPR should consider applying this approach to pension trustee boards? And perhaps such an approach should also take into account the skills and knowledge of their advisers. We are keen to participate in the review due in 2008, on the code, scope guidance, indicative syllabus and the toolkit.

Relationships of the governing body
Conflicts of interest

19. The NAPF welcomes the inclusion of conflicts of interest by the TPR in its regulatory priorities. We support the Regulator's approach that the key message should be to ensure that conflicts are identified and managed appropriately, using necessary mechanisms to deal with any potential conflicts.

20. We have a specific concern over conflicts concerning advisers, in particular where an adviser presents a product or service provided by the same firm or an affiliate – an example of this would be a fund-of-funds or manager-of-managers

product or service. At this point, the advice could be considered conflicted, and not therefore independent. The question to be addressed is how the conflict of interest should be managed and what if any controls should be required to ensure that it is managed properly.

21. On issuing guidance TPR should include examples of what controls can be put in place to help trustees monitor and manage any potential conflicts that may arise.

Monitoring of employer covenant

22. Again we think this is an important regulatory priority for TPR, especially given its objectives to limit risk to the PPF. We agree with TPR that trustees need to understand the financial strength of the company and any implications for the scheme. This may be an area where specific guidance could be made available by TPR. The issue of smaller schemes needs to be considered in more detail, and perhaps a cost-benefit analysis undertaken to determine the best approach.

23. The NAPF support TPRs approach to help trustees embed monitoring of the employer covenant into their activities.

Relations with advisers

24. We support, in principle, the proposal that the Regulator should issue questions for trustees to ask advisers, we think this could go some way in helping schemes get the best out of the expertise on offer. In addition, we think the TKU should take into account the use of expert advice by trustees in decision-making, and rather than requiring every trustee to have full TKU, perhaps further advice could be provided in ensuring trustees get the best advice from providers and challenge and assumptions they are unhappy with. Schemes spend considerable sums on expert advice, we believe this should be taken into account when reviewing TKU in 2008.

25. The NAPF produces guidance and training to help trustees make the most of their advisers. We are also currently working on a project to help pension schemes choose investment consultants that are skilled in advising on when to select and de-select their fund managers. We will be happy to share these with TPR and discuss how such tools can be used by all trustees in managing relations with their advisors.

26. The NAPF already issues questions for trustees to ask advisers in specific areas, we would be happy to help the Regulator develop questions using the expertise of our membership to ensure the correct questions are included. We think the same approach can be used by both small and large schemes, though we recognise that smaller schemes may use the same adviser more often due to cost issues.

Procedures of the governing body
Administration

27. The NAPF think scheme administration is an important regulatory priority, whilst many schemes provide high standards of administration there have been some experience by members and trustees of poor levels of administration. The NAPF supports the idea of the promotion and sharing of good practice in scheme administration. In addition, we support the provision of guidance for all third parties and the use of improvement and third party notice where there are persistent or wilful breaches of legislation.

28. We would welcome TPR's promotion of review and adherence to SLA's (in contract and trust based schemes) which could help strengthen trustees monitoring of the provider's performance, via regular administration reports, giving the provider opportunity to demonstrate where they have met or exceeded the required standard. Administration reports can act as an early warning system for trustees of any potential or serious lapses in administration standards. Members could take comfort from positive disclosures in trustee's annual reports/periodic member communications of the quality of administration services, or at least an explanation that improvements are being made. This in turn could enhance both members' and by extension the public's perception of pensions generally.

29. It is important to highlight that a great deal of good work has already been done in this area, for example the Raising Standards of Pensions Administration. In January they published a general statement of administration standards. The statement provides both trustees and suppliers to the industry with a statement of standards by which they are expected to conduct business. A copy is available from the website www.raisingadminstandards.com

Processes for investment choice

30. The NAPF agree with the Regulator that processes for investment choice, especially in a DC environment, is an area that should be treated as a priority.

31. As the TPR is aware, the NAPF is currently undertaking a review of compliance with the Myners Principles on Institutional Investment in the UK. Our work includes a major consultation and research exercise on whether, and to what extent, pension schemes are complying with the Myners Principles.

32. We suggest that the TPR should only decide on its policy in this area, once the research has been completed this autumn. Nevertheless, we would be pleased to meet with TPR to outline the initial findings of our consultation and research in order to help the TPR consider this issue.

Governance during wind-up

33. Good governance during wind-up is essential and we are pleased that TPR has this as one of its regulatory priorities. If a scheme wind-up is not done properly it can have significant impact on members getting benefits correctly and damage trust in pensions going forward. The NAPF would encourage TPR to continue to work closely with the PPF on increasing standards in this area.

34. In terms of the new proposals suggested by TPR, we support the approach being proposed as part of the government's initiative to improve the winding-up process.

Question 4. Are there particular points you wish to make about any of the priorities?

35. The NAPF is a strong advocate of good governance and we are pleased that TPR has recognised this as a priority.

36. Whilst we support many of the regulatory priorities for ensuring scheme are well run, we think they may rely too heavily on the TKU of trustees. We would like the Regulator to consider other means of improving governance.

37. In addition, as already noted, we would urge the Regulator to defer taking substantive decisions on its approach to investment issues until after the NAPF has completed the review of compliance with the Myners Principles. While the review is due to be submitted to the Treasury in October, the NAPF would be pleased to share its initial assessment with TPR prior to this.

Questions 5. Do you have suggestions for how these priorities should be addressed for smaller schemes?

38. We support the suggestions put forward in the paper using a proportionate and risk-based approach to regulation. (include list of proposals we support)

39. Given that the burden of trusteeship is growing, a challenge which often cannot be easily met by the very large number of small occupational pension schemes (80% of which have fewer than 12 members), we suggest that the Regulator should promote ways to encourage the consolidation of such schemes. In July 2005, the NAPF published a discussion paper on Pension Scheme Governance[2]. In the paper we thought there may be considerable scope for bringing together smaller schemes under a multi-employer arrangement with an overarching governance structure which would enable the cost of governance to be shared.

[2] Pension Scheme Governance – fit for the 21st Century?

40. In addition, where consolidation may not be possible/desirable, it may be appropriate to consider what more can be done to help very small schemes adopt good governance standards.

Questions 6. Do you agree with our analysis of contract-based schemes, and the new proposals we are considering on:

41. We agree with TPR's analysis. This is an area we highlighted in "Pensions Scheme Governance – fit for the 21st century?". In that document we highlighted three ways of improving governance in such schemes by:
    a. creating a trust board;
    b. establishing a Management Committee, or
    c. setting up a Pensions Committee.

• providing examples of employer-led 'management committees'?

42. We believe there is scope to look more closely at encouraging employer-led management committees for contract-based schemes. We support the idea that this could be done on a voluntary basis for those employers who may wish to play a greater role in monitoring the contract-based scheme.

43. The Printing Industry Pension scheme goes someway to providing this sort of governance arrangement already. The Printing Industry Pension Scheme (PIPS) was established in 1986 by the employer federation (the British Printing Industries Federation BPIF) and the trade union (now Unite the union) for companies without occupational pension arrangements. It currently operates on a stakeholder/GPP basis. It has a management committee which comprises 50% employer representatives and 50% union representatives, in both cases elected form the BPIF's and Unite's governing bodies. The Management Committee has an independent secretary and chair which changes every two years. It is independent from both the union and the federation and retains executive control of the scheme. The management committee meets with the advisers to ensure the scheme is run in the interests of scheme members.

• guidance providing questions to ask on commission and fees?

44. Without a trustee board or management committee it would rest with the employer to fulfil this role. Where the employer has set up a contract based arrangement they are unlikely to want to take on this task unless pushed by scheme members.

• administration?

45. We agree that TPR proposals on improving administration in contract-based schemes by providing examples of service level agreements, we think this could help employers get the right level of service and help with member queries as

and when they arise. We also support the proposals to encourage employers to carry out regular reviews of the contract-based scheme provider. Also see comments in paragraph 29.

• **investment processes?**

46. The paper does not directly acknowledge the Myners principles and how they could be used to help in this process. The NAPF is in the process of reviewing the Myners principles on behalf of HM Treasury. We believe that principles can act as a useful code and we think TPR should consider this in further detail and how it might usefully apply to managers responsible for the investment processes in contract-based schemes

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