

Opra: Tackling the risks to pension scheme members



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
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executive summary

- 1 This report examines how the Occupational Pensions Regulatory Authority (Opra) seek to protect the interests of people who belong to an occupational pension scheme or other work-based pension¹. Opra were established in 1996 under the Pensions Act 1995 (the Act). They are a non-departmental public body sponsored by the Department for Work and Pensions (the Department). Opra are an important element in the regulation of work-based pension schemes that enable people to supplement the State pension arrangements². The general principle is that these pension schemes are discretionary, funded from contributions by an employee, or their employer, or both, to a dedicated fund.
- 2 Work-based pensions are a major source of income of people after retirement. It is Government policy that such pensions should provide an increasing proportion of post-retirement income. They comprise occupational pensions, personal pensions and stakeholder pensions. Occupational pension schemes hold assets in total of around £770 billion and have 25 million members³, and are typically the responsibility in statute of trustees nominated by the employer and by members.



- 3 For people to be prepared to invest in work-based pensions they need to be confident that the assets are secure. Serious irregularities in the Mirror Group Pension Scheme from 1991 led to a review of pensions law in general (the Goode Committee), and the Pensions Act 1995 implemented many of the recommendations of this Committee⁴. The Act clarified the duties placed on pension scheme trustees and placed a duty on their professional advisers to report some breaches of the Act. It established Opra to receive these reports and enforce the new regulatory regime. The Act also established a Pensions Compensation Board to compensate members of schemes for losses incurred due to dishonesty where the employer is insolvent.

¹ Work-based pensions are those pensions whose arrangements are to some extent facilitated by the employer. See Figure 4 on page 11 for details.

² The State pension is calculated on the basis of National Insurance contributions made while in employment.

³ There is considerable double counting in these figures as many people belong to more than one scheme. Figures are taken from the Opra web site, www.opra.gov.uk and the Association of British Insurers web site, www.abi.org.uk, as at the time of writing.

⁴ Pensions Law Reform, the Report of the Pension Law Review Committee - Chairman: Roy Goode, CM 2342, HMSO, September 1993.

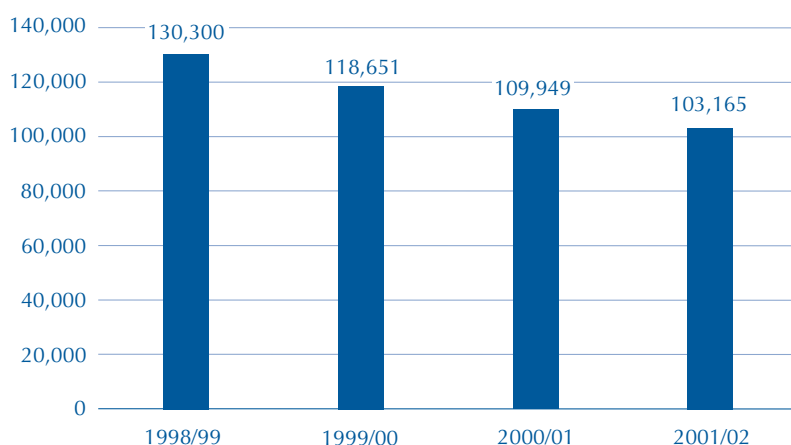
4 The Act gives Opra a wide range of powers. In particular, they can in defined circumstances remove, suspend or appoint trustees to schemes, initiate court action for breaches of the Act which are subject to criminal penalties and fine trustees, employers or providers who have breached legal requirements. Opra also took over the pre-existing Pension Scheme Registry, which holds some details of schemes to help members trace their schemes. Subsequent legislation has:

- changed from criminal to civil the sanctions for the most frequently reported breaches of the Pensions Act;
- extended Opra's powers to cover some aspects of personal and stakeholder pensions, including registration of stakeholder pension providers and regulation of employer access to stakeholder pensions; and
- given Opra greater input into the process of winding-up pension schemes.

Opra's running costs are met by a levy on pension schemes (£15 million in 2001-02)⁵.

5 Our examination took place at a time of substantial change. There are falling numbers of occupational pension schemes (**Figure 1** shows the trend from 1998-99, which is in line with a longer-term decline in the number of schemes). Sponsoring employers are switching many schemes from providing members with a defined benefit after retirement to receiving defined contributions where the employees' benefits depend on the performance of the fund assets. This switch to defined contribution applies mostly to new members rather than to existing members of schemes. There is also a perception that many people are making insufficient provision for their pensions and that pensions law is too complicated. Opra have no remit or powers to address these issues directly, although their work should encourage public confidence in pension schemes.

1 The number of live occupational pension schemes 1998-99 to 2001-02



Source: Opra Annual Reports



⁵ The levy also broadly meets the costs of the Pensions Compensation Board (paragraph 3 above) and the Pensions Ombudsman, whose remit is to investigate and decide complaints and disputes about the way pension schemes are run, often at the request of individual members.

- 6 The Department are responsible for the policy and regulatory framework for pensions. To address concerns about the apparent decline in work-based pensions, the Government commissioned two reviews which reported in July 2002, which have implications for the work and role of Opra⁶. The Department have also established a Quinquennial Review of Opra. The Government intend to publish a Green Paper on occupational and personal pension policy in autumn 2002, alongside the conclusions of the Quinquennial Review.

Main findings

The current regulatory arrangements address only some of the risks to pensions provision

- 7 Opra have statutory powers to act in specified ways in cases where the governance of pension schemes has breached the law. Poor governance can result in members receiving reduced benefits (Figure 2), especially where a scheme is closed, and very occasionally can involve misappropriation of scheme assets. Opra's regulatory processes should help protect members against some of the key risks we have identified, but there are gaps. For instance, Opra have no process for identifying cases where the trustees have not appointed professional advisers unless someone (for example, trustees, other advisers, or scheme members) reports the deficiency to them.

2 Summary of governance-related risks to pension scheme members

- Misappropriation of pension scheme assets
- Funds are insufficient to provide pension scheme members with the benefits that they could reasonably expect due to
 - Insufficient contributions to the scheme
 - Inadequate or inappropriate investment
 - Risks arising from the wind up process
- Incorrect benefits accrue to scheme members in due course
- Scheme members lose track of pension schemes or vice versa

Source: National Audit Office

- 8 Some other risks to pension scheme members are addressed by the Financial Services Authority, the Pensions Ombudsman and other bodies. There is currently no body that has an overarching view of all aspects of work-based pensions, and the Pensions Simplification Review has recommended the creation of a new kind of regulator which would give guidance to pensions professionals and to Government as well as regulating individual pension schemes⁷. The pensions regulators in the Republic of Ireland and the Netherlands have such a role.
- 9 Occupational pension schemes vary substantially in size and in the types of benefit they confer on their members. Most are small. Of the 103,000 live schemes at March 2002 (Figure 1), only 21,000 had 12 or more members. On the other hand, 89 per cent of members belonged to the 1,761 schemes with over 1,000 members. The large number of schemes, coupled with the view that all scheme members should be equally protected, leads to a heavy workload on Opra, while the diversity of schemes gives rise to different types of risks.

6 Department for Work and Pensions, *A Simpler Way to Better Pensions (The Pensions Simplification Review or the Pickering Review)*, 11 July 2002. HM Treasury, *The Review of Medium and Long-Term Savings in the UK*, 9 July 2002 or the Sandler Review. Their findings are summarised in Appendix 4.

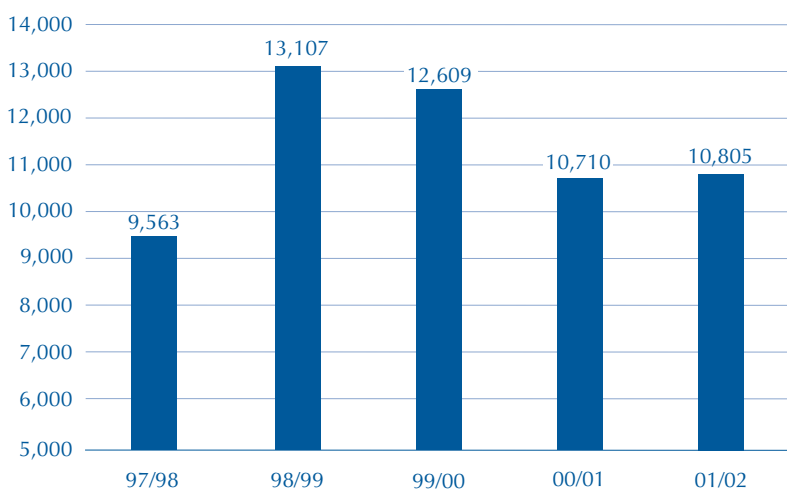
7 Department for Work and Pensions, *A Simpler Way to Better Pensions (The Pensions Simplification Review or the Pickering Review)*, 11 July 2002. The findings are summarised in Appendix 4.

- 10 There is little, however, that any regulator could do directly about one of the biggest risks to pension scheme members receiving the pension they expect, that of the employer going out of business or closing the scheme⁸. Employers are not obliged to provide an occupational pension scheme and incur significant cost in supporting one. Scheme trustees are volunteers, mostly unpaid, whose dedication and goodwill is essential to good governance. The burdens of regulation, including Opra's actions, could increase the risk of employers closing their schemes to the detriment of the members concerned.

Opra have encouraged better governance of pension schemes

- 11 In their first five years Opra received 56,000 reports about breaches of occupational pensions law. They have responded in a variety of ways including sending warning letters, undertaking investigations, initiating criminal sanctions, imposing fines and reporting auditors and actuaries to their professional bodies. Research undertaken in 2002 indicates that in most cases of trustee breaches the trustees had complied by the time Opra closed the case. Opra have also provided educational material to trustees and others which is well regarded. These actions have raised awareness of the behaviour expected of trustees and their advisers.
- 12 The number of breaches being reported to Opra has fallen (**Figure 3**), suggesting that Opra's work may have improved some aspects of the governance of pension schemes. And since 1997 the Pensions Compensation Board has had to make compensation payments in only three cases. It also seems likely that Opra's work to heighten awareness of trustees' duties will have improved the ways schemes are run in other ways, for instance because trustees take greater interest in investment performance.

3 Reports to OPRA about occupational scheme breaches



- 13 Opra have acted effectively in cases where schemes were left without trustees. In 2001-02, for instance, Opra appointed trustees to 509 schemes releasing assets of £45 million for the benefit of nearly 4,000 members⁹. They have helped accelerate the winding up of schemes and also intervened in several cases where the actions of the trustees gave cause for concern.

⁸ If the employer closes the scheme, it is still liable to fund for pension rights already accrued. If an employer becomes insolvent, then insufficient funds may mean that all members may suffer - pensioners and, more probably, employees (future pensioners). The risks to members once a scheme is closed relate to pension rights that an employee would have expected to gain in the future.

⁹ Opra Annual Report 2001-2, page 18, July 2002.



Opra have limited information on the outcome of their work

- 14** Opra's performance measurement systems concentrate on the time taken to undertake key processes, and to a large extent their targets have been met. Until 2002 they did not seek to determine what effect their interventions had had on improving scheme governance. Nor do they have any measure of how many schemes have suffered serious problems. Their understanding of the extent to which the interests of pension scheme members are better protected as a result of their work is largely anecdotal. An internal audit review has questioned whether Opra's intervention made a direct difference in the cases reported to members' interests for a substantial proportion of trustee breaches examined; and whether fining trustees for breaches after they have rectified the problem, as often happens, sends out the right messages.
- 15** Apart from limited details of schemes held by the Pension Schemes Registry, Opra have had to rely on surveys, which until late 2001 have been too small to permit statistical conclusions to be drawn, to determine how well schemes more generally are complying with legal requirements. This means that their information on schemes is largely limited to the quarter of the schemes that have given rise to reports. The surveys that Opra have undertaken provide evidence that for schemes otherwise unknown to Opra compliance with legal duties and trustees' understanding of their role is often poor. The limited information also reduces Opra's ability to advise the Department more generally on pension schemes.

Opra's work has focused on reports that pose a low risk to scheme members

- 16** Auditors and actuaries are required to report to Opra any breaches of employers' or trustees' legal duties where these are material to Opra's functions, and trustees are required to report some types of breach. Opra started from the generally held assumption that their role was to act on breaches of the Pensions Act and the Department's informed forecast of 3,000 breaches a year. They provided some guidance on materiality but in practice the number of breaches was four times that forecast and most of the 56,000 breaches reported to Opra in their first five years have not represented any significant risk to member's interests:
 - some 60 per cent of reports have been of late payments to schemes, where the impact is negligible to an ongoing scheme so long as the payment is eventually made. In 2000-01, almost half of the late payment cases (over 3,100) were less than 10 days late. Furthermore, most reports have been of isolated incidents.
 - of the reports of trustee breaches, a quarter had either been rectified at the time of the report or within two months of the statutory deadlines. In some other cases the scheme was already actively seeking to comply.
 - most breaches are not serious enough to merit consideration of a punitive sanction by Opra's Board, and many of those that have gone to the Board have been fairly insignificant. As 65 per cent of fines for late payments breaches did not exceed £50, the deterrent effect may have been insufficient to justify the significant processing costs involved.
 - the high number of breaches reported by auditors and actuaries may reflect a justified fear that failure to report even trivial breaches of duties would result in a penalty from their professional body.

- 17** Opra have felt obliged to give some attention to every reported breach, and told us that their response was in line with their understanding of the original intention behind the legislation. That is, that breaches subject only to criminal law sanctions until 2000 (the majority of reported breaches) should be treated with equal seriousness thereafter, and that they had to gain practical experience of the effectiveness of the new civil penalties before considering whether other approaches should be used. They decided in early 2002 that the use of civil penalties for punishing schemes was not working well and therefore even more emphasis should be placed on education as opposed to punishment. In our view, the focus on handling and considering for punishment a large number of reports has been at the expense of targeting effort on improving pension scheme governance, for instance in some self-administered schemes where controls might be weak.

It has taken Opra a long time to develop their approach to identifying high risk schemes

- 18** The intention from 1997 was that Opra should identify trends and lessons learned as they processed reports of non-compliance. They would then have been able to use this information to develop a more risk-based approach. However, the volume of reports was greater than either the Department or Opra expected, tying up more of Opra's resources and leading to a larger data analysis task. Matters worsened in 2001 when pension providers were required to report late payments by employers of personal pension contributions to Opra. They received over 250,000 reports compared with the 10,000-30,000 which the Department and Opra had forecast on the basis of research.
- 19** In 2000, a high profile case involving the removal of some £2.9 million from a scheme, resulting in criminal proceedings, suggested that Opra had been slow to identify potential risks to members' funds. The independent review that the Department commissioned into this case resulted in 2001 in a series of recommendations to strengthen Opra's approach to handling cases. In particular, Opra in Autumn 2001 introduced a risk-based approach to identifying high risk cases. The new procedures are largely working as intended although there have been problems with the timeliness of some risk assessments and in obtaining the information needed to make an assessment.

Opra's objectives do not clearly articulate how their work should protect pension scheme members

- 20** Unlike many other regulators Opra's functions or objectives are not specified in their governing legislation. Opra therefore drafted their own objectives, agreed with the Department in 1997. These objectives largely did not specify what Opra should seek to achieve in using their powers, for instance reducing risks, compliance with the law or punishing offenders. Nor did Opra analyse what risks they intended to address through using their powers. Opra's objectives focused on reacting to reports of breaches of the Pensions Act. It would have been difficult for Opra initially to take a more strategic view as they, and the Department, lacked information on the extent of pension scheme compliance with the principles of good governance. Opra consider that the further responsibilities, such as for personal pensions (paragraph 18 above), given to them had to be treated as a high priority and therefore developing a more risk-focused approach received a lower priority.





- 21** As Opra's knowledge of pensions governance increased so did their perception that the powers in the Pensions Act, as they interpreted them, constrained their work. For instance, a restrictive interpretation of their powers to ask for information limited their work towards their objective of surveying pension schemes in general. There are undoubtedly some significant constraints. For instance, the Pension Schemes Registry appear to be unable to collect and record information not needed for its original purpose of tracing schemes but which might then assist Opra's regulatory functions. While some legislation was eventually changed, Opra made only limited attempts to test what different approaches they could adopt, in part because they lacked the strategic objectives and risk models needed to justify changes. The uncertainty about statutory powers may have contributed to the difficulty that Opra experienced in dealing speedily with some schemes involved in a relatively new development threatening scheme members' interests, pension liberation.
- 22** The Department's own objectives for private pensions relate only to encouraging greater personal provision for retirement. It has not, however, been clear how Opra should work towards this objective, for instance whether through minimising regulatory burdens on schemes or through providing public information on the relative security of scheme members' funds. In the absence of definitions within the Pensions Act, the Department left it to Opra, as an independent non-departmental public body operating at arm's length from Ministers, to use their knowledge and experience to define and refine their detailed functions and objectives. When Opra referred to the Department questions about what they could do or asked for legislative constraints to be lifted, the Department generally responded cautiously.
- 23** Opra have proposed new outcome-based objectives in Summer 2002. This change complements a number of long-standing initiatives to underpin their work with a more risk-based approach, including:
- using survey evidence to improve the identification of high risk cases; and
 - a systemic approach to reports about late payments to personal pension schemes that is being extended to occupational pensions.

Principal recommendations

24 In the five years since their establishment Opra have helped improve the governance of pension schemes. They have had to learn much about the nature of the problems and risks that they are regulating and have found themselves constrained by their interpretation of legislation, a heavier than expected workload and taking on new powers. They recognise that a new approach is needed that builds on their experience and expertise that is unique in the work-based pensions field. Furthermore, they are very likely in due course to face the challenge of implementing the new legislation arising from the Pensions Simplification Review and Government Green Paper, and the detailed recommendations for change made by the Quinquennial Review. In going forward we recommend that Opra should in particular:

- (i) **Become better informed about the risks facing pension scheme members.** No regulator can regulate without information. But the limited information on the quality of scheme governance or wider risks to scheme members available to Opra constrains their ability to identify risks to pension scheme members. The Pension Schemes Registry could provide Opra with much of the relevant information, although Opra will need to clarify the Registry's role as an information gatherer for regulatory purposes. They should also conduct more substantial surveys of schemes, building on the survey work they already undertake to estimate compliance of pensions schemes. They should use the information gathered to develop the risk analysis at Appendix 5 so as to identify future priorities for pensions regulation.
- (ii) **Specify clearly Opra's regulatory functions and objectives.** Unlike other regulators Opra do not have a document that articulates what they are seeking to achieve and how their work contributes to the intended outcomes, nor one that specifies what are their regulatory functions. To assist in taking regulatory actions in a consistent and transparent manner, Opra should ensure that their staff and the pensions community are clear about their role. Opra's draft objectives and the risk analysis recommended above would provide a good starting point. In the process Opra may identify appropriate regulatory functions for which their powers are unclear or defective and should seek clarification or legislative change accordingly.
- (iii) **Develop different communication approaches for different types of scheme.** Opra recognise that they could do more to help improve scheme governance and raise their public profile. They should provide guidance (possibly by codes of good practice) on the features of a well-run scheme, which may differ for different types of scheme, with examples drawn from their experience and that of relevant professional bodies. They should consider how to target pertinent information at different types of scheme, for instance by newsletters and bulletins. In doing so they could learn from the example of the Pensions Board, the Irish pensions regulator, and like them also take a prominent role in promoting training for trustees and administrators.
- (iv) **Develop distinct regulatory approaches for different types of scheme.** The risks involved in different types and sizes of schemes vary. To be proportionate, so should Opra's regulatory response. For instance, many of the risks associated with fully-insured schemes rest in practice with the scheme providers. As they commonly provide services to many schemes, targeting them might have more impact than targeting individual small schemes. Similarly, the good governance of large schemes may necessitate controls that would be inappropriately burdensome for small schemes. The approach being adopted for personal pensions provides an example of how action to improve compliance can be targeted at the primary causes, in this case insurance companies.

- (v) **Shift their resources to target the schemes and common weaknesses posing the greatest risks.** Opra should continue and expand their present efforts to identify the risks which should receive priority and focus resources accordingly. This could involve more effort applied to educating or intervening in schemes where significant risks are apparent. They should revise their performance measures to focus on the improvements in scheme governance they have secured, so as to inform future priorities and resource allocation.
- (vi) **Focus more regulatory effort on providers and third-party administrators.** Opra have found that the root cause of many Pensions Act breaches reported to them is not the trustees or employers, but the administrators of pension schemes, and independent financial advisers. While Opra have very limited powers in relation to such bodies, they should seek to work with them to improve scheme administration and involvement and consider seeking statutory powers if there is resistance to this approach, perhaps on the model of the new powers of direction for wind-up.
- (vii) **Raise the threshold for the reporting by whistleblowers of breaches of the Pensions Act.** Handling a large number of reports restricts Opra's ability to target more important risks to pension scheme members. The Pensions Act requires whistleblowers to report breaches of statutory duties only where they are likely to be of material significance to Opra's functions. To reduce the volume of reports they receive, Opra should give more specific guidance, drawing on their risk analysis, on the circumstances that are material. They should work with the professional bodies to prevent trivial reports, making it clear to advisers and trustees that they will not be penalised for non-reporting if they take a reasonable judgement on materiality.

For the Department for Work and Pensions

- 25 The Department are considering the recommendation of the Pensions Simplification Review that there should be a "new kind of regulator". In doing so they should be clear about what they expect Opra, or any new regulator, to achieve and how Opra should report performance against this expectation. They should consider giving "the regulator" the role of being the Government centre of expertise on work-based pensions and an overarching role to lead on all aspects of regulation. They should agree with Opra what changes to legislation would be needed to give "the regulator" sufficient powers and discretion to act at arm's length; for example, the powers to collect the information necessary to fulfil the role the Department establish for them and other gaps identified in Part 2 of this report.