National Audit Office

The Pensions Regulator: Progress in establishing its new regulatory approach

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 1035 Session 2006-2007 | 26 October 2007

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LONDON: The Stationery Office
£13.90

Ordered by the
House of Commons
to be printed on 23 October 2007

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This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

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23 October 2007

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CONTENTS

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SUMMARY

1 Some 20 million people in England and Wales have private sector work-based pension schemes. The Pensions Regulator (TPR) was established on 6 April 2005 to regulate these schemes, of which there are some 84,000.[1] TPR's statutory objectives are to protect members' benefits, promote improved governance of such schemes, and to reduce the risk of compensation being paid out by the Pension Protection Fund (PPF).[2] TPR is not responsible for regulating whether individuals are making adequate provision for their retirement. The Department for Work and Pensions is responsible for pensions policy while the Financial Services Authority is responsible for regulating the sale of financial products and for promoting public understanding of financial services and products.

2 TPR replaced Opra[3], on which the National Audit Office (NAO) and the Public Accounts Committee (PAC) published reports in 2002 and 2003.[4] These reports found that the regulatory arrangements at that time addressed only some of the risks to pensions provision, and Opra had not focused on the greatest risks to pension scheme members.

3 This report evaluates the progress of TPR in establishing its new regulatory approach. Since TPR has been in existence for only two years it is too early to conclude on its impact on long term pensions issues. This report therefore focuses on evaluating whether TPR has put in place appropriate processes to meet its statutory objectives in a risk-based manner and whether deficiencies in Opra's approach have been remedied.

Overall conclusion

4 The issues facing pensions are long term but subject to a great deal of ongoing short term volatility. For example, movements in the stock market on a single day in February 2007 added some £11 billion to the value of pension scheme deficits taking the total deficit to some £35 billion.[5] Drawing conclusions on the effectiveness of pensions regulation must therefore be set in the long term context rather than based on shorter term fluctuations. Our conclusion is based on the regulatory approach that TPR has taken and whether this addresses the key risks.

5 We found that TPR has made good progress in establishing a risk-based approach to regulation. It has focused on those areas that currently appear to present the greatest systematic risks to pension scheme members and the Pension Protection Fund (PPF). This stands in contrast to Opra, which had not distinguished adequately between trivial and high risks. TPR has also developed an appropriate regulatory approach which focuses on influencing those actors who make decisions on pensions such as scheme trustees and professional advisers. As TPR matures, it has the scope for a presumption of further transparency in its approach, and is taking steps to increase the information it makes available to the pensions sector. TPR initially focused on final salary pension schemes, where it has had to implement two substantial new areas of regulation, but during 2007 it also clarified its intended approach to money purchase schemes.[6] Money purchase schemes present very different risks to members and many have very different governance arrangements to final salary schemes. Since employers are increasingly shifting provision from final salary to money purchase schemes this will be an important and challenging area for TPR in the future.

Detailed findings

- **The Pensions Regulator's statutory objectives provide a sound framework for pension regulation and it has established clear links between these objectives and its operational approach.** The 2002 NAO and 2003 PAC reports found that a lack of clear objectives had prevented Opra from articulating how it would protect pension scheme members. TPR was given four broad strategic objectives by the Pensions Act 2004 which it interpreted in the context of the prevailing risks in the pensions environment. Seventy eight per cent of TPR's stakeholders believe that risks to members would increase in TPR's absence.[7]

- **TPR has a broader range of powers than the previous regulator.** The 2002 NAO and 2003 PAC reports found that Opra had inadequate powers, for example in terms of enforcing compliance or gathering information. TPR has been granted additional powers to remedy these inadequacies. Seventy three per cent of TPR's key stakeholders consider that TPR has adequate powers[8] although some of the key new enforcement powers remain untested.

- **TPR has developed a risk-based approach to focus its activities.** In its 2003 report the PAC found that Opra had not taken a risk-based approach to regulation and had therefore failed to protect members from the greatest risks. TPR has set itself up to take a risk-based approach. It has processes in place to identify and assess generic pension risks and to categorise individual schemes to reflect this assessment. It has also implemented a range of IT systems to enable more sophisticated risk analysis. In future, TPR is planning improvements in its systems that will allow it to test and refine further the approach.

- **TPR draws on a wider range of data than the previous regulator and has refined its approach to data collection; data quality and completeness remains a priority.** TPR inherited unreliable and incomplete data from Opra. In conjunction with the Pension Protection Fund (PPF), TPR is gradually cleansing this data and has created a return to be filled in by all schemes. This return is web-based and has built in checks to help ensure data credibility. TPR now has data on 99 per cent of final salary schemes and 32 per cent of money purchase schemes by membership. It is currently collecting scheme data for the remaining money purchase schemes and expects by March 2008 to have requested all such schemes to complete a return.

- **The quality of governance of pension schemes varies widely and TPR is working to improve standards.** To meet its statutory objectives TPR must rely on good governance by those individuals, both lay and professional, who govern pension schemes, in particular trustees. Opra and TPR research shows that there is a strong link between trustee knowledge and understanding and good governance. TPR has several activities aimed at improving governance, ranging from codes of practice to guidance and an e-learning toolkit for trustees. Stakeholders we spoke to commented that the Trustee toolkit in particular is an innovative approach to raising governance standards and by September 2007 there were some 20,000 registered users. Seventy eight per cent of TPR's key stakeholders consider that TPR is a trusted source of information.
- **TPR cannot have close direct contact with all 84,000 pension schemes and therefore must influence behaviour indirectly by signalling to the market its expectations.** To do this effectively a regulator should have a presumption towards transparency in its regulatory expectations and decisions. TPR has developed a range of approaches to communicate its expectations and provides much information on its regulatory approach, for example through codes of practice, guidance and statements of regulatory approach. Historically TPR has not routinely published its findings and determinations. This is because it is required by statute to ensure that funding is scheme specific and it is concerned that publishing this information will encourage all schemes to adopt similar funding approaches. As of September 2007 TPR has adopted a presumption towards publishing its future determinations and it is keeping its policy on case examples under review. TPR also does not publish case examples where it considers that the case may set misleading precedents or where there are commercial confidentiality issues.
- **TPR initially focused on final salary schemes and governance issues where the need for action was most urgent and the risks to members greatest.** TPR's focus on final salary schemes was due to two major new regulatory requirements of the Pensions Act 2004, and the pressing need to secure appropriate funding levels for schemes covering some 14 million members. Recent third party research and the initial scheme valuations provided to TPR[9] indicate that most companies are planning to reduce deficits over shorter timescales than previously, are giving attention to their obligations to support schemes, and are setting higher levels of funding. At the same time TPR has given priority to legislative requirements regarding scheme governance such as issuing codes of practice.
- **TPR's approach to money purchase schemes initially had a lower priority.** This lower priority reflects the smaller membership of these schemes, at some 5.5 million members, the absence of major legislative change, the different nature of the risks and the longer timescale available to tackle them. TPR research from 2006 shows that TPR generally had a lower profile with money purchase than final salary schemes and that governance standards were lower in money purchase than for equivalent sized final salary schemes. Following its consultation document of November 2006 TPR clarified its approach in April 2007, which focuses on raising awareness of its role and giving greater focus to smaller schemes. In money purchase schemes, it is important that individual members understand the risks they face and the need to ensure they are making adequate arrangements for their retirement. However, TPR has no formal role in the financial education of individuals. The Financial Services Authority (FSA) leads the national strategy for financial capability which aims to improve the public awareness and understanding of the financial system, including public understanding of pensions.

Recommendations

6 TPR has made good progress in establishing its regulatory approach. Risks in the pensions environment can change quickly and the following recommendations are framed with this in mind.

a The impact and nature of the long term risks to pensions will change over time. For example, if TPR is successful in reducing or eradicating pensions deficits this risk, which is high at the moment, will diminish. One of the key shortcomings of the former regulator was its inability to respond appropriately to the emergence of new risks. TPR has built a framework that has demonstrated flexibility in responding to the risks identified and to new risks emerging. In order to remain effective it must ensure that it retains this flexibility into the future, for example by setting up new specialist business units or changing its organisational design as appropriate.

b One of the key risks to money purchase schemes is a lack of member understanding. In order to regulate these schemes TPR has built a relationship with the Financial Services Authority (FSA) as the responsibility for improving the public awareness and understanding of the financial system, including their understanding of pensions, rests with the FSA. TPR should build on this relationship to ensure that it inputs at the appropriate time into the FSA's development of strategic priorities for financial capability work.

c It is best practice for a regulator to be transparent in its decision-making so that the regulated entities are clear on the regulator's expectations. TPR provides information on its regulatory approach, for example in codes of practice, guidance, and regulatory statements, and does now have a presumption towards publishing its determinations. It does not publish the outcomes or reasoning for its decisions in relation to specific individual cases unless they are subject to formal determination. This is because funding levels are required to be scheme specific and it does not want to publish information which may be perceived to set a target, discourage schemes from approaching the regulator, or is commercially sensitive. As the market matures TPR should have a presumption towards greater transparency with a view to publishing more individual cases.

d TPR has greatly improved the quality of its regulatory data, particularly in relation to final salary schemes. The compendium report of final salary scheme data produced with the PPF[10], and the report on the first 1,300 recovery plans[11] are examples of this. As the regulator collects more data on money purchase schemes it should look to publish a similar body of evidence.

PART ONE

Statutory background and the pensions environment

1.1 This section describes the pensions landscape and the creation of TPR. It also covers the scope and methodology of the report.

The pensions environment

Types of pension scheme

1.2 There are two principal types of pension scheme. **Final salary** schemes typically pay the scheme members a proportion of their final salary on retirement. **Money purchase** schemes typically pay out a sum based on the value of the member's fund at the time of retirement. **Figure 1** gives details of the characteristics of these schemes. Some employers also offer hybrid schemes which typically offer a pension based on a combination of final salary and returns on investments made by the scheme member.

1.3 Final salary schemes and the majority of money purchase schemes have trustees who are appointed to govern the scheme in the best interests of the members, called a trust-based scheme. These trustees may be professional or lay. Some money purchase schemes do not have trustees but instead have a direct contract between member and provider, called a contract-based scheme. A typical provider will be an insurance company and the contract will be between the insurance company and the scheme member. Since there is no trustee the role of the employer and the member in ensuring good governance becomes more important.

1.4 The risks to members of final salary and money purchase schemes are very different. In the case of a final salary scheme the principal risk to members is that the scheme has insufficient funds to meet the promised level of income on retirement and the sponsoring employer is unable to make up the deficit. Money purchase schemes do not promise a particular level of pension to be paid on retirement. The principal risks to members of money purchase schemes are therefore a lack of member understanding of the levels of contributions needed to ensure an adequate pension on retirement, greater complexity of scheme administration, unduly high charges, and exposure to poor investment strategy by the scheme administrators.

1.5 Final salary schemes generally tend to be larger than money purchase schemes with some 1,400 having over 1,000 members. By contrast, just over 200 money purchase schemes have over 1,000 members and some 90 per cent of money purchase schemes have fewer than 10 members. In both types of provision a large proportion of members belong to a relatively small number of large schemes.

Trends in the pensions environment

1.6 The provision of work-based pensions faces a number of long term issues which are set against ongoing short term volatility. The principal long term issues are:

- **The shift away from final salary to money purchase pension schemes:** A trend for employers to close final salary schemes to new members has been established for some time. For example, an estimated 54 per cent of final salary schemes closed to new members between the end of 2001 and the end of 2004. By October 2005 only 24 per cent of FTSE100 companies offered such a scheme to new members.[12] This decline has been accompanied by an increase in the number of money purchase schemes offered by employers. **Figure 2** shows the shift in membership between the two types of scheme.
- **Funding deficits in final salary schemes:** Many final salary schemes have funding deficits against the levels needed to pay benefits as they fall due. Recent research indicates that there are many reasons behind this, including expectations of increasing longevity of members, and falls in the value of underlying investments.

- **Demographic changes:** The proportion of working to retired people is declining and expectations of longevity are increasing. These factors are increasing the cost of pensions provision. For example, a one year increase in life expectancy can increase the liabilities of a particular scheme by 3-4 per cent.[13]

1.7 Set against these long term trends is short term volatility created by technical factors, such as day to day changes in stock market valuations and interest rate movements, and behavioural factors such as an employer's reluctance to continue to offer certain types of retirement provision or offering scheme members financial inducements to change schemes. For example, movements in the stock market on a single day in February 2007 added £11 billion to the total estimated deficits of pension schemes.

TPR's role and statutory background

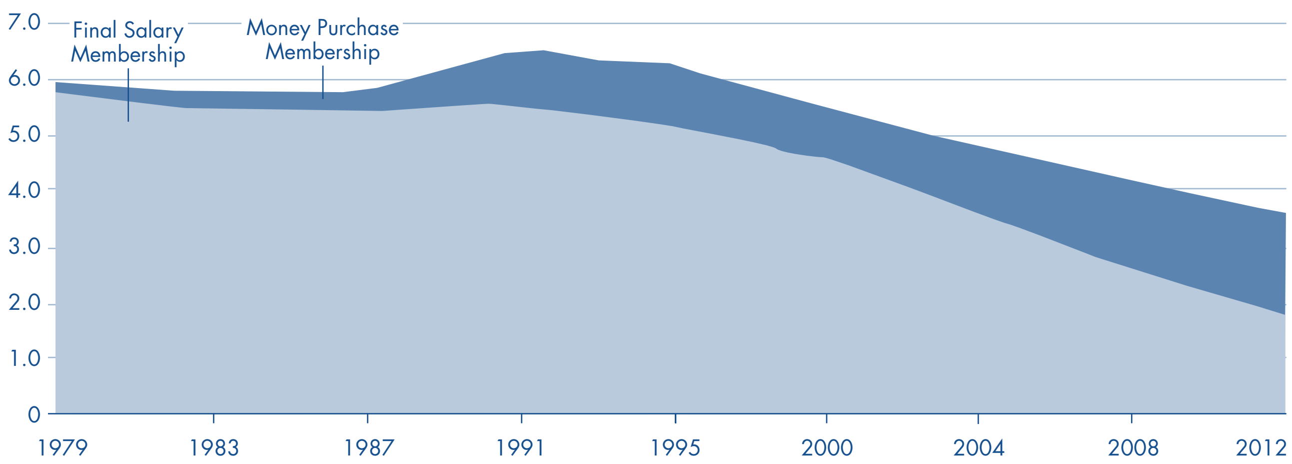
1.8 TPR was established in April 2005 to regulate work-based pensions and replace the previous pensions regulator, Opra (the Occupational Pensions Regulatory Authority). Opra had been established in 1997 in response to concerns about the security of pensions schemes, particularly following the Maxwell case where some £440 million had been misappropriated from a number

1 Characteristics of typical final salary and money purchase pension schemes

	Final salary	Money purchase
Employee contribution	Fixed as a proportion of salary	Fixed as a proportion of salary
Employer contribution	Dependent on calculations of how much is needed by the fund to meet its liabilities	Usually fixed as a proportion of the employee's salary
Basis of payout to scheme member	Related to final salary and the number of years of contribution to the scheme	Related to the value of the investment portfolio on retirement
Comments on main scheme risk	The risk of being unable to meet the scheme liabilities rests with the employer	The risk of not having adequate payout on retirement rests with the employee

Source: National Audit Office

2 Actual and predicted active membership in private sector occupational schemes to 2012 (millions)



Source: GAD Survey/DWP "Shifts in the Pensions Landscape"

NOTES

1 This figure covers active members who are working and contributing to a pension scheme. It does not include Group Personal Pensions or Personal Accounts.

2 By 2012 active members of occupational schemes may be split 50:50 between final salary/money purchase schemes.

3 Predictions added based on rate of change from 2000 to 2004.

of pension schemes. The 2002 National Audit Office and 2003 Public Accounts Committee reports found many shortcomings with the previous regulator's approach to regulation:

- The regulatory arrangements addressed only some of the risks to pensions provision.
- The regulator had not articulated clearly how its work would protect pension scheme members.
- The regulator had focused on trivial issues that posed a low risk to scheme members.
- There was limited information on the outcome of the regulator's work.

1.9 Appendix 2 sets out the findings of the PAC report and progress since then. In addition, in June 2002, the Pickering Report[14] called for the simplification of the regulatory framework for pensions. It recommended the establishment of a pensions regulator that would be outcome and customer-focused, transparent, proportionate and risk-based in its approach.

1.10 Against this background the Pensions Act 2004 established TPR, the Pension Protection Fund (PPF), and the Financial Assistance Scheme (FAS) with effect from April 2005. TPR was given four strategic objectives **(Figure 3)**, and tasked with taking a risk-based approach to regulation. The annual cost of TPR is some £30 million and it employs over 300 staff.

3 TPR's statutory objectives (Pensions Act 2004)

Strategic objectives

1 to protect the benefits under occupational pension schemes of, or in respect of, members of such schemes,

2 to protect the benefits under personal pension schemes of, or in respect of, members of such schemes,

3 to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund,

4 to promote, and to improve understanding of, the good administration of work-based pension schemes.

Source: Pensions Act 2004

1.11 TPR is one of a number of pensions bodies in the UK (Appendix 3 gives further details). Its key relationships are with:

- the Department for Work and Pensions which sponsors most of these bodies (including TPR) and develops pensions legislation;
- the Pension Protection Fund which compensates members of qualifying pension schemes that have insufficient funds; and
- the Financial Services Authority which regulates the sale and marketing of personal pensions and which has an objective to improve the financial capability of UK consumers.

Audit scope and criteria

1.12 TPR was established to take a risk-based approach to regulating work-based pension schemes and thereby to contribute to DWP's objective of increasing confidence in pensions. TPR has statutory objectives and new powers with this in mind. Many of the pensions issues that the regulator faces are long term and it is too early to use outcome-based information to draw any full conclusions on TPR's success in achieving its statutory objectives. However, it is possible to evaluate whether TPR has put in place appropriate processes to take a risk-based approach to regulating pensions, and whether it has remedied the deficiencies in its predecessor's organisational design and approach to pensions regulation. We have therefore undertaken a review of risks in the pensions environment and TPR's approach to regulating for these risks.

1.13 There are three elements to our evaluation which form our audit criteria:

- Whether TPR's statutory framework and its interpretation of its objectives enables it to take an effective risk-based approach (Part 2).
- Whether TPR has put in place appropriate processes for gathering data on and analysing risks (Part 3).
- Whether as a result of the risks identified TPR is using its new powers appropriately and has developed strategies for mitigating the risks identified (Part 4).

1.14 More information on audit scope, criteria and methodology is at Appendix 1.

PART TWO

TPR's interpretation of its objectives and its operational response

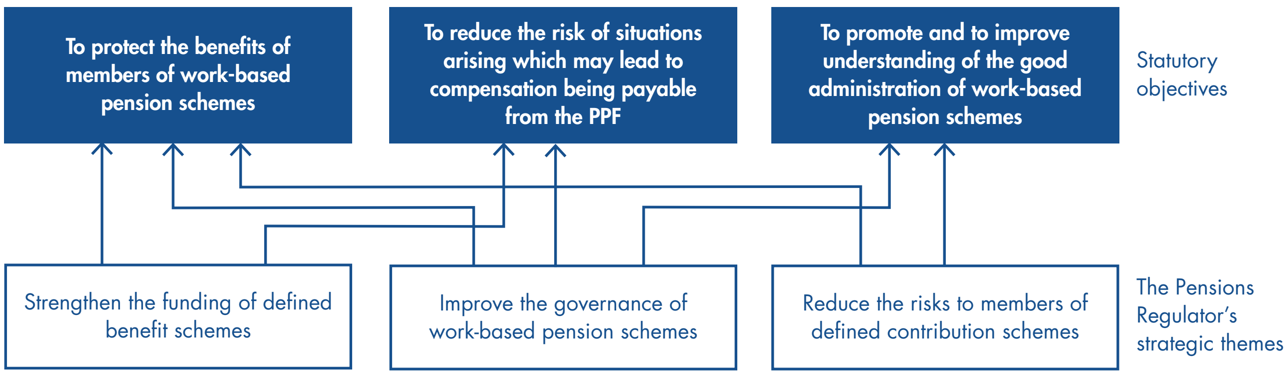
2.1 This section describes TPR's statutory background, TPR's interpretation of its objectives, and the operational achievements against these objectives. It shows that:

- TPR has statutory objectives that provide a sound framework for pensions regulation and it has established clear links between these objectives and its operational approach.
- To date, TPR has focused mainly on final salary pensions since these schemes cover the majority of pension scheme members, the need for action has been most urgent in this area, the risks to members are greatest, and legislative changes required two new regulatory approaches to be developed.
- Money purchase schemes are becoming increasingly widespread and present a different set of risks to members. The regulator is now focussing on the risks in these schemes as envisaged in its medium term strategy.

2.2 The principal challenge for any regulator is to interpret its statutory objectives in a way that reflects the current needs of the regulated area and allows it to develop an appropriate operational response. The 2002 National Audit Office and 2003 PAC reports found that Opra had failed to build a strategy focussing on the most serious risks and had therefore failed to protect members. TPR's first challenge was therefore to interpret its statutory objectives in the context of the main risks facing scheme members and the PPF and devise an operational response to protect these bodies.

2.3 TPR set out clearly its interpretation of its operational objectives in its initial medium term strategy, produced in 2005. This covered the three years from 2006-07 to 2008-09 and demonstrated how its statutory objectives linked to its work programmes based on its assessment of the most serious risks **(Figure 4)**.

4 Statutory objectives and core themes



Source: TPR

NOTE

Since the first two of TPR's statutory objectives are closely aligned they have been amalgamated, giving three objectives overall.

2.4 Overall, seventy eight per cent of TPR's stakeholders believe that the risks to members' benefits would increase in the absence of the regulator.[15] We also found that TPR's stakeholders believed its medium term strategy focused on the most appropriate areas.

Scheme funding

2.5 The first strategic theme relates to final salary schemes only. Final salary schemes cover some 14 million members with scheme assets of around £700 billion. The principal risk to members of these schemes and to the Pension Protection Fund (PPF) is that a scheme is not adequately funded. Scheme members may not then receive their full entitlement and calls may be made on the PPF.

Scheme specific funding

2.6 All pension schemes are required to do a valuation every three years. The Pensions Act 2004 requires any schemes showing a deficit to put in place a recovery plan and send this to TPR for review within 15 months of the valuation. The legislation also requires both the valuation and recovery plan to be scheme specific, depending on the circumstances of each scheme, and does not specify the length of recovery plans or how valuations should be undertaken. Following consultation TPR issued a code of practice and outlined the process it would use to evaluate valuations and recovery plans in a statement of regulatory approach. TPR has set trigger points relating to the target level of scheme funding and the nature of the recovery plan. These triggers indicate to trustees, advisers and employers those schemes that TPR will investigate further without setting absolute targets. TPR's investigations focus on whether trustees have sufficient and reliable information and whether they have negotiated effectively with the employer.

2.7 It is too early to draw conclusive judgements on TPR's impact on funding deficits. Since schemes have 15 months to submit a recovery plan and all schemes are on a rolling three year valuation programme the final recovery plans will not be received until December 2009. However, recent independent research indicates that companies are increasingly looking to remove pension scheme deficits over shorter time periods. For example, a survey in April 2007 found that 94 per cent of schemes plan to achieve their new funding target in ten years or less compared to 38 per cent two years previously.[16] The initial recovery plans[17] that TPR has received demonstrate that schemes are planning to reduce deficits over an average of 7.5 years, are targeting shorter recovery periods than previously and are targeting higher levels of funding. Details on independent research are in Appendix 6.

Clearance

2.8 The funding of final salary scheme benefits relies on continuing financial support from the sponsoring employers. Since 2003 the only way for the sponsoring employer to remove its obligation to make good any deficits on the scheme has been for it to buy out all the benefits with an EU registered insurance company. The Pensions Act 2004 gave TPR substantial powers to act where employers seek to avoid this obligation or where sufficient support from the employer is not directly available. The Act also gave companies who are entering into a corporate transaction the right to request that TPR gives a 'clearance' statement that it will not use these anti avoidance powers in relation to the specific event cleared, based on the evidence provided to it at the time.

2.9 Where a corporate transaction increases the likelihood of an employer being unable to discharge its obligations, TPR expects the employer to ensure that any potential detriment caused to the scheme as a result of the transaction or event is mitigated. Before giving clearance TPR therefore considers whether appropriate steps have been taken to protect the scheme members and the PPF. TPR also proactively pursues cases of avoidance.

2.10 Clearance requires specialist knowledge so TPR has assembled a team with the skills required to assess complex corporate transactions. To date TPR has given clearance to some 360 corporate transactions as well as handling some 2,100 enquiries from participants in corporate transactions. TPR estimates that its clearance process and associated activities have resulted in substantial additional contributions being paid into pensions schemes, and that its actions have led to changes in scheme sponsors' attitudes towards higher levels of funding.

Scheme governance

2.11 The second theme relates to the governance of pension schemes. Since there are some 84,000 schemes that fall under TPR's remit it cannot have direct contact with all schemes and must rely on good governance by trustees and other scheme professionals to meet its objectives. TPR research, based on initial work by Opra, identified that there were many aspects of scheme governance that did not meet best practice. TPR has developed codes of practice, guidance and other educational activities aimed at improving governance. It has also created an online 'Trustee Toolkit' as an educational resource for lay trustees.

Money purchase schemes

2.12 TPR's third strategic theme covers the risks to members of money purchase schemes and covers a wider range of risks than the theme on final salary schemes. To develop its understanding of these risks and ensure an evidence-based approach to regulating these schemes TPR commissioned a variety of research and convened a cross-industry working group. Following its consultation document of November 2006 TPR published its approach in April 2007. The development of the approach followed that for scheme funding and governance reflecting both the urgent need to address the risks to final salary schemes and the more varied nature of the risks to money purchase schemes. The FSA also has a statutory responsibility to promote public awareness and understanding of the financial system, which also covers all forms of pension provision. TPR therefore has to liaise closely with the FSA on money purchase schemes. The two bodies work closely in accordance with their Memorandum of Understanding, with monthly bi-partite meetings in addition to ongoing liaison at policy and operational level on matters of mutual interest. The FSA is represented on TPR's Advisory Panel and money purchase working group.

2.13 As TPR is still at the early stages of implementing its strategy for money purchase schemes it is too early to assess the impact of TPR on such schemes. TPR's response to its consultation document of November 2006 outlined its regulatory approach and is intended to raise awareness of the standards it expects in money purchase schemes, and in particular that members of trust-based and contract-based schemes are entitled to equivalent levels of regulatory protection.

Performance management

2.14 To ensure that its strategy is having the desired outcomes a regulator needs to measure its performance against its strategic objectives. The 2002 National Audit Office and 2003 PAC reports found that there was limited information on the outcomes of TPR's predecessor's work and this prevented TPR from refining its approach.

2.15 TPR has developed a high level performance indicator for each of its work streams in its medium term strategy **(Figure 5)**. However, at this stage in TPR's development it will be some time before TPR's full impact can be evaluated and much of the information for the measures is not yet available. Data for scheme funding has started to be collected but will not be complete until the last recovery plans are received in December 2009. Some data on money purchase schemes has been collected and more will become available as TPR implements its approach.

2.16 TPR has therefore developed a set of indicators based around intermediate objectives which tie in to TPR's medium term strategy and where measurement data is available. These measures are based on the behaviours and attitudes of those that TPR seeks to influence as well as the stages of implementation of key internal processes. For example, one of the intermediate measures is that 'trustees, employers and their advisers understand scheme funding arrangements'. This is an intermediate measure to ensure that new funding arrangements are implemented effectively. This measure is evaluated using the results from TPR's annual surveys.

5 TPR's key performance indicators

Scheme funding

- Final salary schemes will have completed scheme specific funding valuations and those with deficits will have agreed recovery plans. These valuations should be based on: prudent assumptions for calculating the assets that are needed to cover the liabilities as they fall due; the level of deficit needed to be funded; with the recovery plan taking account of what is reasonably affordable for employers.

Scheme governance

- There will be year-on-year improvement in the extent to which trustees demonstrate knowledge and understanding of the governance requirements for their schemes, as evidenced by surveys of knowledge and understanding and key aspects of governance.

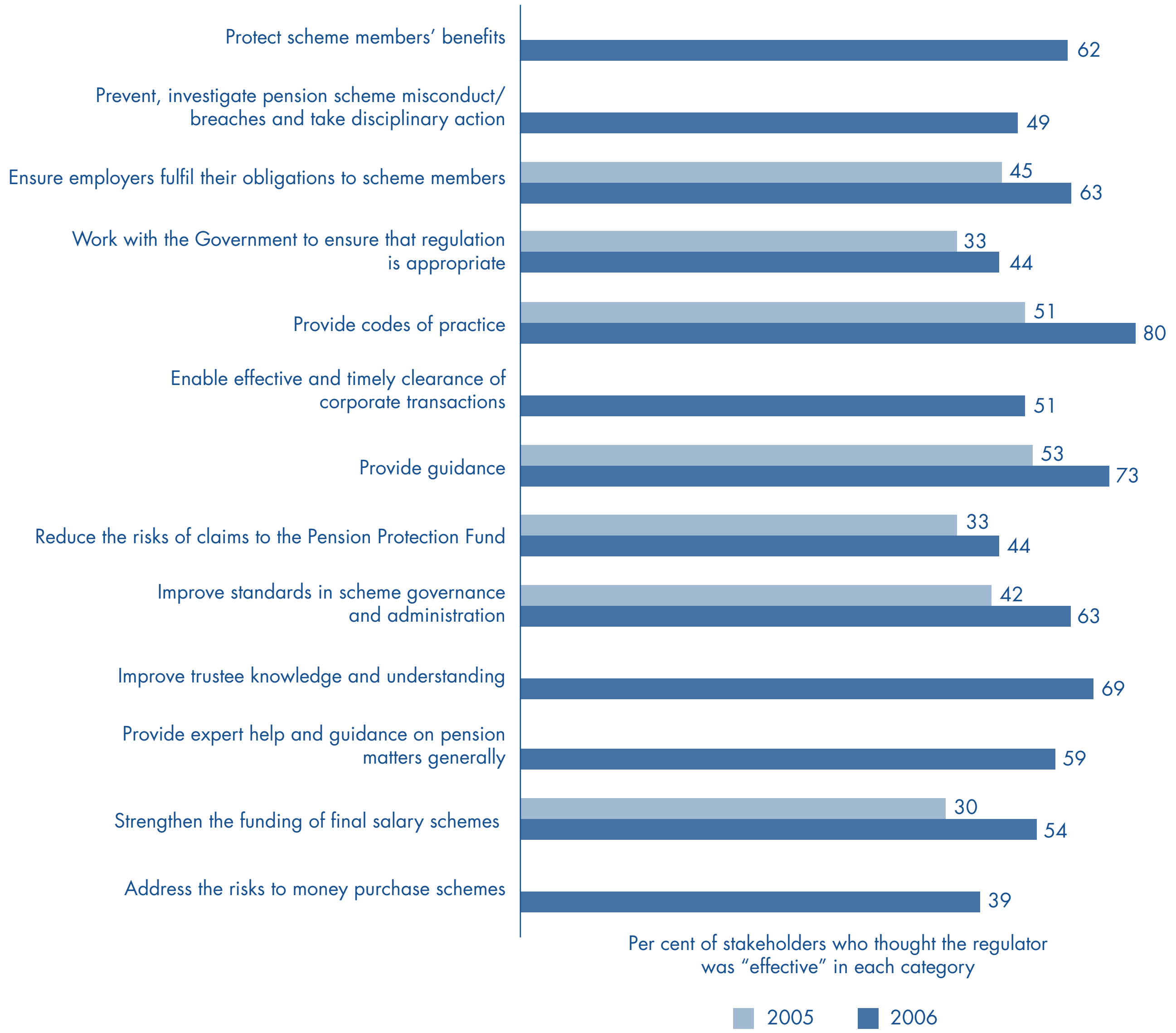
Money purchase schemes

- Trustees and others involved in running money purchase schemes (such as providers, administrators and employers) will have a clear understanding of the significant risks inherent in such arrangements, especially in relation to administration, member awareness and investment, and how they should be mitigating them.

Source: TPR

2.17 The available performance data covering stakeholder views indicates that TPR is having a beneficial impact on members' benefits. **Figure 6** gives more detailed information of stakeholder's views of TPR's performance. This shows that TPR scores most highly on providing codes of practice and guidance and improving trustee knowledge and understanding, and lowest on addressing the risks to money purchase schemes. These results are from TPR's own research which assesses the opinions of pensions professionals and lay trustees. TPR does not seek the views of pension scheme members or beneficiaries since the FSA is responsible for individuals' financial capability.

6 Stakeholder perceptions of TPR's performance against its key challenges



Source: TPR annual perceptions tracker survey results

NOTE

Some questions were not asked in 2005.

PART THREE Risk identification and analysis

3.1 TPR is responsible for protecting members' benefits across some 84,000 pension schemes, but it has limited resources and must ensure that it minimises the burden it places on those schemes. To be effective it therefore needs to identify generic risks that will affect a large number of pension schemes. It also needs to collect enough relevant data to analyse and understand the identified risks and, based on this assessment, allocate its finite resources to those schemes and areas which pose the greatest risks and where it can have the biggest impact.

3.2 This section shows that:

- TPR has developed a risk-based approach to focus its activities. It has processes in place to identify and assess generic pensions' risks and to categorise individual schemes to reflect this assessment.
- TPR draws on a wider source of data than its predecessor and has refined its approach to data collection. Data quality and completeness remains a priority.

Risk analysis

Risks to pension scheme members

3.3 For a risk-based approach to work effectively TPR needs a process for identifying and analysing current risks and their impact on TPR's ability to meet its statutory objectives. The risk assessment must evolve to reflect changing trends in the pensions environment and new risks as they emerge. Furthermore, the regulator must ensure that its operational response is directed at mitigating the risks identified. The 2003 PAC report found that the previous regulator had an inadequate approach to identifying and analysing risk and had therefore failed to direct its resources appropriately.

3.4 We found that following consultation TPR has created a high level risk matrix which details the current risks in the pensions environment. There are currently 18 high level risks categorised across final salary and money purchase schemes, and trust and contract-based schemes **(Figure 7 overleaf)**. Each risk is rated according to impact to TPR, likelihood of occurrence, and external TPR expectations. We also found that TPR has processes in place to include new risks as they emerge.

3.5 We also found that TPR ensures that its operational response is directed at mitigating the 18 high level strategic risks identified and that new risks identified at an operational level are fed into the strategy. TPR ranks each of the 18 high level risks for potential impact and develops a mitigation strategy – covering education, enablement, or enforcement (described in **Figure 8 on page 17** as 'controls'). Figure 8 shows how TPR assesses the impact of scheme underfunding and the controls it has put in place.

3.6 TPR research from 2006 shows that 61 per cent of its stakeholders considered that it was focused on the most important risks to members (63 per cent in 2005). The stakeholders we spoke to also felt that TPR was focused on the appropriate risks. Where stakeholders did identify new risks or risks that TPR should give more attention to stakeholders also commented that TPR consulted widely and that they had appropriate processes to feed in their views to the regulator.

Pension scheme classification based on risk

3.7 To direct its resources to those areas where it can have greatest impact and to ensure that it keeps the regulatory burden to a minimum TPR must identify those pension schemes where the risks are greatest. In its 2003 report PAC recommended that the regulator categorise schemes so that those presenting the highest risk are given the greatest attention.

7 TPR's assessment of the key risks in its regulatory field

Risks relating to both final salary and money purchase trust-based schemes

Governance risks

Trustee ignorance/incompetence – members' benefits are not adequately protected due to ignorance or incompetence of the scheme trustee.

Conflicts of interest (trustees) – trustees act in the interests of the employer or sections of the membership rather than in the interests of the full membership.

Inappropriate advice to trustees – trustees take poor decisions due to receiving ill-informed, biased, or conflicted advice from pension professionals.

Wind-ups – members' benefits are put at risk or delay, and/or winding up costs eat excessively into benefits due to the inefficiency of trustees and professionals in winding a scheme up.

Miscellaneous

Fraud and financial crime – members lose benefits due to misappropriation of scheme assets.

Late or non payments – pension schemes are either unable to meet their liabilities or the entitlement to benefits is not established because employers pay late and/or fail to pay contributions to schemes.

Breaches of pensions law – members are not adequately protected due the failure of a scheme to comply with pensions legislation, for example the lack of a formal disputes resolution process.

Risks relating to final salary schemes only

Under funding – members lose benefits because final salary schemes are not prudently funded to meet liabilities as they fall due.

Corporate transactions – members lose some of their pension entitlement because corporate transactions enable the scheme sponsor to avoid its full pension liability.

Multi-employer withdrawal – an employer withdraws from a multi-employer scheme without effective arrangements to protect the pension scheme.

Employer abandonment – a final salary scheme ceases to be sponsored by an employer of substance who can fund any deficit.

Transfer values/inducements – members are induced to transfer out of a final salary scheme without fully understanding the financial consequences.

Scheme administration – poor quality funding decisions are made due to inaccurate member records.

Final salary scheme member understanding – members take ill informed decisions due to poor quality communication from trustees on the nature of and risks to their benefits.

Risks relating to money purchase schemes only

Scheme administration – members do not receive expected benefits due to poor record keeping or poor administration of the investment portfolio.

Member understanding – members make poor decisions on their pension provision due to lack of understanding of scheme risks and benefits.

Money purchase scheme investment – members' benefits are substantially reduced due to poor investment strategies or monitoring.

Source: TPR

8 An example of TPR's detailed assessment of one of its key risks

Task	Controls	Narrative with actions
Risk Type Scheme underfunding Schemes Final Salary Meaning Final salary schemes are not prudently funded to meet liabilities as they fall due, taking account of the employer covenant, increasing longevity and the risks around the schemes' investments. Impact Members' benefits will not be delivered or the exposure to Pension Protection Fund is excessive with consequences for scheme levy.	Educate Seeking to move the market through education and guidance, in particular codes of practice, regulator's statements, guidance and trustee toolkit. Also roadshows and a range of other campaigns. Enable Customer support team provides support for all schemes with upcoming valuations, and follow up late arrival of recovery plans. The specialist Scheme Specific Funding team contacts all FTSE 100 companies as their valuations become imminent. Enforce Action will be taken in higher risk schemes where trustees do not engage appropriately. TPR follows an escalation route from seeking information through to strengthening the trustee board. Ultimately it will impose schedules of contributions where it believes that the funding settlement is imprudent or inappropriate or the trustees and employers fail to agree.	Scheme funding has been the top priority. Scheme funding strategy agreed in May 2006, codes, guidance, and regulator's statement produced to help articulate the strategy. The focus for the future will be on using evidence from recovery plans, advisers' and scheme returns to target education and intervention on problem areas. Also work with the actuarial profession for greater recognition of increasing longevity.

Source: TPR

3.8 We found that TPR has built a model which categorises schemes according to risk and enables it to direct its resources to the areas where its assessment shows the risks to members' benefits are greatest **(Figure 9)**. The risk assessment is based on the level of potential risk and the level of potential impact. Since 85 per cent of scheme members are in the largest two per cent of schemes (representing some 1,600 schemes) TPR has used size as a key determinant of risk. The other is TPR's assessment of risk based on its understanding of generic risks in the pensions environment. The model determines the level of activity that TPR will dedicate to a particular scheme. It is split into four categories each with a different response based on the assessment of risk to members and TPR's ability to respond.

- **Active intervention:** All schemes in this quadrant are considered high risk. They will also all have cases open against these schemes and they will be resource intensive. During 2006 and 2007 there were between 150 and 300 schemes in this category at any one time.

  Data gathering: Frequent face to face meetings, close working with PPF, regular reviews and requests for bespoke additional information.

- **Intelligence-based action:** The schemes in this category have experienced an event which increases the risk of a loss for members, such as fraud or gross mismanagement. However, since the size of the schemes is small the loss will only affect a few members. TPR therefore collects further intelligence to determine whether the overall risk level merits active intervention. To identify the schemes in this quadrant TPR has to spot commonalities across schemes such as a suspect trustee, adviser or employer.

  Data gathering: Work with other agencies (FSA, PPF), scanning of industry information, core data in scheme return.

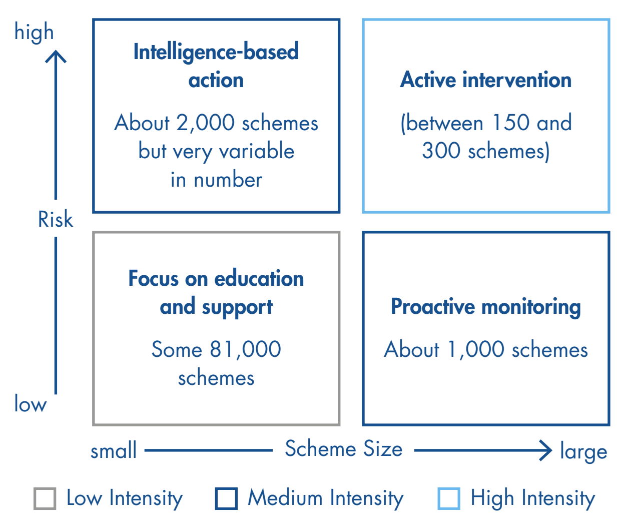
- **Proactive monitoring:** During 2006 and 2007 there were some 1,360 large schemes that had not triggered any specific actions from TPR. The regulator considers these schemes to be potentially risky because, although the scheme risks appear low, any problems will affect a large number of members.

  Data gathering: Monitoring of market activity (Merger and acquisitions, restructuring), possible face to face meetings, scanning of scheme and employer data (for example, accounts).

- **Minimal scheme specific action – focus on education and support:** These schemes have not triggered any specific enforcement actions from TPR. The regulator therefore focuses on providing educational materials to these schemes and enables risk mitigation through responding to queries or whistleblowing reports.

  Data gathering: Core data only (scheme return).

9 Scheme classification model



Source: TPR

Regulatory data

Data sources

3.9 The ability of the regulator to identify and analyse risk, or formulate an intervention is largely dependent on good quality data. It needs high level data on the pensions environment so that it can identify new and changing systemic risks, for example data on funding levels over time. It also needs low level data on specific schemes and employers so that it can identify and respond to problems in high risk schemes.

3.10 In its 2003 report, PAC noted that Opra had gaps in its information gathering powers that had prevented it from gathering even basic data such as the addresses of trustees. Furthermore, TPR inherited data from Opra that had not been collected or used on a risk basis and much of which was collected manually.

3.11 TPR was given explicit information gathering powers in the Pensions Act 2004. We found that it has used these new powers to widen the information gathered both at the scheme level and on the wider pensions environment.

Scheme data

3.12 There is no existing comprehensive and reliable repository of pension scheme data. TPR must therefore collect this information itself. The scheme data that TPR inherited from Opra was incomplete and unreliable. An internal audit report in 2006 found that information was held on a number of databases which were often inconsistent. TPR therefore faced a challenge to both improve and clean the data it inherited and also to install processes for gathering more useful information in the future.

3.13 TPR collects scheme information on behalf of the Pension Protection Fund (PPF). The PPF uses scheme data to calculate the levy that is payable by all schemes to its compensation fund and to ensure that every scheme pays the required amount. The PPF therefore requires complete and accurate scheme data. Since TPR inherited data from Opra which was incomplete and inconsistent TPR and PPF have focused over the last 12 months on improving data quality. To improve the historical information TPR put the scheme data it inherited from Opra on a single core database and put it through a cleansing exercise.

3.14 To ensure that TPR has good quality scheme data into the future it issued a scheme return in Autumn 2005 aimed at gathering basic scheme information. This initially presented problems since it was paper-based and needed to be keyed in manually by TPR. The return was lengthy and not all schemes filled in all the information. At one stage 50 per cent of queries to TPR were about the scheme return. TPR subsequently halved the data requirements of the return to reduce the burden, make it more user friendly, and reflect its data needs. To improve data reliability TPR has also moved it to a web-based return. This allows the IT system to check automatically the credibility of data prior to the form being submitted.

3.15 TPR now has data on 99 per cent of final salary schemes and 32 per cent of money purchase schemes by membership. It has a timetable in place to ask all schemes to complete returns by March 2008. TPR and PPF are also currently considering working together to create a joint database of scheme information to ensure greater consistency.

Wider pensions environment

3.16 TPR draws on a wider source of information than Opra to underpin its understanding and analysis of risk, including whistleblowers' reports, scheme funding information, additional information requested from individual schemes, and horizon scanning.

Data analysis

3.17 TPR inherited data systems from Opra that were largely manual. This meant it could only perform basic risk analysis on its data. To allow more sophisticated risk analysis TPR has installed a number of data management IT systems and recruited a new head of research as well as statistical staff. These systems manage and enrich the existing data, for example by adding company share price information, credit ratings data or flags where data might indicate a higher level of risk. TPR is continuing to explore ways of increasing intelligence gathering and enhancing its analysis capabilities. TPR has recruited a new head of research as part of a programme aimed at increasing the quality and sophistication of its analytical resources.

Risk-based decision-making

3.18 Amongst the most severe failings of Opra was its tendency to treat all cases as the same and therefore focus on a large number of trivial events. Furthermore, its data requirements compounded the problem by requiring schemes to notify Opra of events, many of which related either to trivial risks or no risk at all. As a consequence Opra received 56,000 reports in five years and became heavily burdened by this volume since it did not filter and classify the information according to risk. In its 2003 report PAC found that Opra was ineffective because it did not differentiate properly the information it gathered according to risk.

3.19 We found that TPR has recognised that risk assessment is complex and subjective and has put in place processes to ensure that data is filtered according to risk and that there is consistency of decision-making.

Filtering of enquiries

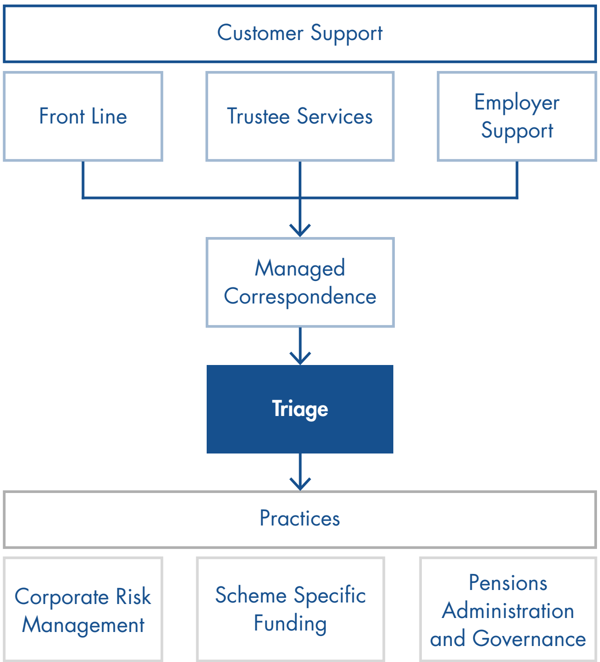
3.20 In a typical month TPR receives some 2,500 queries or notifications, ranging from a simple change of trustee details to detailed information on major corporate transactions, and which indicate very different levels of risk. **Figure 10 overleaf** shows how TPR's regulatory delivery function is structured to ensure that data is filtered appropriately and flows through the organisation according to the level of risk indicated. It gives examples of typical queries for each area.

3.21 We found that TPR's filtering processes direct the greatest attention to information which indicates the biggest risks to members. Of the 2,500 queries that TPR typically receives per month, the triage process reduces this to around 100 high risk issues which then become cases. TPR is then able to direct its resources towards those cases which demonstrate the highest risk. By comparison, Opra was attempting to spread its resources across some 1,000 reports per month on average.

Consistency of decisions

3.22 The decision to escalate data determines whether risks are analysed at the correct level. Since this evaluation of risk will naturally involve an element of intuition and judgement there is a risk that decisions will be inconsistent or that risks will be missed.

10 Information filters in TPR



Source: KPMG and National Audit Office

NOTES

The Customer Support and Managed Correspondence teams deal with any issues that do not represent a significant risk. Examples include requests for advice or assistance, minor breaches, and certain notifiable events that indicate a low risk.

The triage team deal with any issues that cannot be dealt with in Customer Support, for example a notifiable event that breaches certain defined criteria.

The specialist practices deal with high risk cases. Corporate Risk Management deal with applications for clearance, the Scheme Specific Funding team deal with scheme funding issues and the Pensions Administration and Governance team deal with administrative and governance issues.

3.23 Opra had trialled a scoring system so that those cases that scored highly were regarded as high risk. However, this proved overly mechanistic and overall risk scorings proved to be inconsistent with the regulator's judgement of risk. TPR has therefore deliberately introduced processes that allow for more intuitive judgements. However, to ensure consistency and quality of judgments the regulator has developed 'business rules'.

3.24 'Business rules' are a set of decision-making criteria that determine how certain types of information are dealt with. An example is the business rule on scheme recovery plans. Pension schemes that are in deficit must submit a recovery plan to TPR which details how the deficit will be recovered and over what time period. To ensure that TPR's decision-making is consistent it has created a set of questions with 'trigger points' that indicate whether further action should be taken. TPR staff use the business rules to guide their analysis of the deficit recovery plans.

3.25 TPR also uses its staffing policies to ensure the quality and consistency of its decisions and that it has appropriate in-house skills and knowledge. About five per cent of its current staff are on secondment from financial or other regulatory institutions. The secondees are selected to bring in specific skills and knowledge to TPR, but also to ensure that knowledge of TPR's workings is taken back to the secondees' employers.

PART FOUR

Intervention and influencing behaviour

4.1 Since there are some 84,000 work-based pension schemes TPR cannot directly protect members' benefits and must therefore influence the behaviour of a range of intermediaries such as pensions professionals and lay trustees. TPR therefore needs the necessary powers to influence behaviour and to use these powers appropriately. It needs different intervention strategies for different types of scheme based on its assessment of risk and it needs to be visible to all of the pensions community to be able to influence behaviours.

4.2 This section evaluates whether TPR has developed an effective intervention strategy, including whether it has the necessary powers and processes for influencing behaviour. It shows that:

- TPR has a broader range of powers than its predecessor. TPR has used its new powers to gather data and issue guidance. To date the regulator has used the threat of enforcement rather than enforcement itself to influence the desired behaviours. Some of its enforcement powers therefore remain untested.
- TPR cannot regulate all schemes directly and must therefore make the most of its influence over a range of actors who make decisions on pensions. TPR has developed a range of regulatory approaches for influencing behaviour, for example publishing codes of practice, developing an online toolkit for trustees, and publishing strategy and research publications. However, it has not routinely published its findings and determinations or case examples since it does not want to set benchmarks for its decisions or reveal commercially confidential issues. It is now moving towards publishing its determinations.
- The quality of governance of pensions schemes varies widely and TPR is working to improve standards.

TPR's new powers

4.3 The 2002 National Audit Office and 2003 PAC reports found gaps in Opra's powers:

- It could fine trustees for non-compliance (for example not producing audited accounts for the year) but it could only enforce compliance by appointing an independent trustee, whose costs would be borne by the scheme.
- It had no powers to act against employers' attempts to avoid meeting their pensions obligations. And it had no duty to do so.

4.4 Under the Pensions Act, TPR has been granted new powers. These include:

- requiring a specific action to be taken within a certain time by issuing an improvement notice, or a third party notice;
- acting against employers' attempts to avoid pension obligations or failing to adequately support a scheme by issuing a Contribution Notice, a Financial Support Direction or a Restoration Order; and
- widening the circumstances in which TPR can act against trustees for not being fit and proper.

The regulator also has powers to require schemes to be adequately funded, to clear corporate transactions, or other certain specified types of event, in respect of their impact on pensions, and to require restoration of funds where it believes these have been removed inappropriately. Furthermore, TPR has greater powers than Opra to obtain information, for example through the scheme return and through its notifiable events regime, which requires certain types of event to be notified to the regulator such as a proposed takeover of the company; and to publish guidance and codes of practice.

4.5 The stakeholders we interviewed felt that TPR's powers were stronger and more relevant than those of Opra, but that many of its new powers had not yet been tested. Seventy three per cent of TPR's stakeholders considered that it has sufficient powers.

How TPR uses its powers to influence the market

4.6 TPR rarely makes decisions on the funding and governance of pension schemes directly. Rather, it places reliance on the capacity of a range of actors who do make regular decisions on pension schemes. To be successful in meeting its statutory objectives TPR needs to ensure that these actors are able to adopt the right behaviours. For example, members of money purchase schemes must make informed decisions if they are to receive appropriate benefits on retirement, and trustees must have the confidence to act where a corporate transaction is not in the best interests of members, while advisers need to know when to draw matters of concern to TPR's attention.

4.7 TPR does not have the powers or resources to take these decisions itself although it can intervene where it believes the trustees are ineffective. **Figure 11** describes who the actors are that TPR seeks to influence and the behaviours that TPR requires from them. TPR's role concerning the knowledge and understanding of members of pension schemes is limited to the provision of information to them by those running the schemes. The FSA has a statutory responsibility to promote public awareness and understanding of the financial system, which also covers all forms of pension provision. TPR therefore liaises closely with the FSA to ensure that it influences those who do have a role over members.

11 The behaviour that TPR seeks from those that are involved in running pension schemes

Pension scheme individual	Behaviour required by TPR
Trustee	To look after the interests of scheme members and other beneficiaries
	Trustees are legally responsible for the way that schemes are run. TPR expects them to have sufficient knowledge and understanding, to put in place effective adminstration, internal controls, investment and governance processes; for final salary schemes to understand the strength of the employer and negotiate effectively; and for money purchase schemes to understand and address the specific risks. They must also report to TPR, where appropriate, specific Notifiable Events and material breaches of the Pensions Acts
Employer	To pay over members' and employers' contributions to the scheme accurately and on time
	To honour their pensions' promise
	To report to TPR, where appropriate, specific Notifiable Events and material breaches of the Pensions Acts
Pension scheme lawyer	To provide the trustees with sound advice, for example, on their responsibilities under the Pensions Act and the interpretation of the trust deed
	To report to TPR, where appropriate, material breaches of the Pensions Acts
Pension scheme actuary	To provide the trustees with sound advice, for example, on the longevity assumptions that should be used to calculate the scheme liabilities
	To report to TPR, where appropriate, material breaches of the Pensions Acts
Pension scheme auditor	To audit the scheme's accounts
	To provide the trustees with sound advice, for example, on compliance with the accounting requirements for pension schemes
	To report to TPR, where appropriate, material breaches of the Pensions Acts
Pension scheme administrator	To provide the trustees with sound advice, for example, on the scheme for early retirements
	To administer the scheme effectively
	To report to TPR, where appropriate, material breaches of the Pensions Acts
Investment adviser	To provide the trustees with sound advice, for example, on the choice of investments
	To report to TPR, where appropriate, material breaches of the Pensions Acts

Source: National Audit Office

4.8 To ensure that schemes are regulated well TPR needs the range of actors to make good quality decisions based on the unique requirements of the pension scheme. TPR must therefore encourage decisions which focus on the specific needs of an individual scheme and avoid setting minimum standards which may encourage all schemes to adopt unthinkingly the same approach.

4.9 To meet its objectives successfully TPR needs to assure itself that trustees and the other actors described in Figure 11, such as professional advisers, have the capacity to adopt the role of key decision-maker. We found that TPR has grouped its ability to influence their behaviour and raise capacity into three activities - education, enablement and enforcement.

- Education covers the educational materials and activities that TPR has produced such as strategy and research papers, codes of practice and the trustee toolkit. (paragraphs 4.11 – 4.15)
- Enablement covers the support that TPR gives to pensions scheme trustees and others, such as providing clearance or work that customer support does with trustees. (paragraph 4.16)
- Enforcement includes strengthening the board of trustees, applying specific powers (such as the imposition of a schedule of contributions) or civil or criminal sanctions. (paragraphs 4.17 – 4.21)

4.10 TPR uses a combination of these activities in response to the risk assessment made in its strategic risk model. For example, a risk assessed as high (for example scheme underfunding) will potentially be mitigated using all three activities: codes of practice; interaction between TPR and the scheme on appropriate funding levels; and, if necessary, enforcing employer contributions. A risk assessed as low (for example payments that were received late) will be mitigated principally by educational activities.

Education

4.11 Since TPR relies on intermediaries to meet its statutory objectives it must ensure that those individuals, both lay and professional, govern the schemes well. This requires them to have a good knowledge and understanding of pensions issues. In its 2003 report the PAC recommended that Opra worked to improve levels of knowledge and understanding. Furthermore, TPR's own research indicates that improving the governance of schemes must be one of TPR's main priorities.

4.12 Trustees have fiduciary duties to protect the interests of pension scheme members and beneficiaries. The trustee role is therefore closely aligned with TPR's objectives. The regulator can therefore seek to place reliance on the trustees to meet its own statutory objectives. However, to achieve this trustees must have the necessary expertise and skills and know when to take independent expert advice on key issues.

4.13 TPR inherited a relatively low level of trustee knowledge and understanding from Opra. For example, 41 per cent of all trustees said they had no training and a further 12 per cent that the training was only of an introductory nature. Furthermore, familiarity with TPR's new guidance and codes of practice was initially relatively low. For example, only 25 per cent of trustees said they were 'very familiar' with TPR's code of practice on reporting breaches of the law.

4.14 TPR's research also shows that there is a strong link between the amount of training that trustees receive and the quality of governance (for example whether the scheme had formal arrangements for managing conflicts of interest). Trustees and professionals of large schemes also displayed a greater level of knowledge and understanding than those of small schemes, and those of final salary schemes are greater than those of money purchase schemes.

4.15 To raise standards of governance TPR has used a range of educational activities:

- **Codes of practice (COP):** Codes of practice indicate to the market TPR's expectations and were a new requirement under the Pensions Act 2004. TPR has issued 10 codes of practice to date. Eighty two per cent of stakeholders consider the regulator is effective in providing codes of practice and that it has handled them well. The stakeholders we spoke to gave a variety of comments on the codes. Some found them overly technical and complicated to understand while others thought that they should be more technical, or were exactly what was required. TPR's own research had similar findings, suggesting that the codes need to be used alongside other means of education.

- **Guidance and research publications:** TPR was given statutory powers to issue guidance. Guidance is an important mechanism to enable TPR to support those who govern schemes and communicate its expectations. TPR has produced guidance in 15 areas ranging from the roles of trustees and employers to technical issues such as scheme abandonment and internal controls. TPR has also produced research publications such as the compendium report of final salary scheme data (produced with the PPF)[18], and the report on the first 1,300 recovery plans[19]. TPR's stakeholder research shows that 73 per cent of its stakeholders consider that it has done a good job in issuing guidance. Furthermore, 78 per cent of stakeholders said that TPR is a trusted source of information (up from 74 per cent in 2005).
- **Trustee toolkit:** TPR commissioned research to determine the most effective way to improve trustee knowledge and understanding. Following this it developed a web-based 'Trustee toolkit' that covers the governance and technical issues. There is no requirement for trustees to complete the learning. Most trustees are volunteers and TPR considers that it needs to incentivise individuals to become trustees and offer support and encouragement for their role. To date some 20,000 people have registered for the toolkit, around 3,300 from money purchase schemes and over 16,700 from final salary schemes. Furthermore, over 70 per cent of schemes have at least one trustee who has used the toolkit and the two main sources of contact that trustees have with TPR are the e-learning tool and the regulator's website. TPR's perception tracker survey found that 89 per cent of respondents who had contact with TPR via the toolkit found it very or fairly useful. The toolkit is continuing to develop with plans to develop further modules such as scheme wind-ups and the Pension Protection Fund.

Enablement

4.16 To support pension schemes proactively TPR has a range of processes called 'enablement' activities. For example it will work with trustees to strengthen scheme funding or secure appropriate assurances where there is a corporate transaction that weakens the future ability of the sponsoring employer to fund the scheme. TPR will also assist companies, for example by giving clearance in relation to corporate transactions. From April 2005 to September 2007, it has cleared over 360 applications and responded to some 2,100 enquiries on corporate transactions.

Enforcement

4.17 TPR was given much greater enforcement powers than those of the previous regulator. To date it has used education and enablement in preference to enforcement. It has not yet felt the need to use its enforcement powers widely considering it more proportionate to use the threat of powers to influence the desired behaviour. In particular TPR believes the threat of a Contribution Notice or a Financial Support Direction has resulted in increases in the funding of pension schemes that are part of a corporate transaction. In June 2007 the regulator made its first determination to issue a financial support direction **(Figure 12)**.

4.18 TPR has however used its enforcement powers to replace and supplement trustees, and also to disqualify a trustee indefinitely **(Figure 13)** or until the order is waived or revoked.

12 Determination to issue financial support direction

TPR made public the following details of its determination:

Sea Containers Limited, the parent company of a group whose activities include container leasing, is registered in Bermuda and until October 2006 its shares were listed on the New York Stock Exchange. It wholly owns SCSL, a service company for the group, which is based in the UK. SCSL is the principal employer to two pension schemes: the 1983 and 1990 schemes. SCSL has been dependent on Sea Containers Limited for its funding, and this was recognised, from 1989 onwards, in a formal agreement between the two companies whereby Sea Containers Limited undertook to indemnify SCSL for certain of its liabilities including pension obligations to its employees.

During the course of 2006, the trustees to both schemes became increasingly concerned over the ability of the principal and other participating employers to support the schemes financially, and notified TPR of their concerns in June. The trustees met with executives of Sea Containers Limited and the company's advisers in September, and were advised of a planned restructuring of the group. However, no proposals were made to the trustees regarding future funding for the schemes, and TPR considered the possible grounds for issuing a Financial Support Direction (FSD).

On 15 October 2006, Sea Containers Limited and SCSL filed for protection under Chapter 11 of the US Bankruptcy Code. Shortly afterwards, TPR sent out Warning Notices to Sea Containers Limited in respect of SCSL's share of the two schemes' buy-out deficits, which estimated the deficits as being approximately £105 million in the case of the 1983 scheme, and approximately £22 million for the 1990 scheme.

At the request of Sea Containers Limited TPR's Determinations Panel held an oral hearing into the case on 12-13 June 2007. The main focus of the hearing was whether it was reasonable for TPR to issue financial support directions. The Panel determined to issue financial support directions. Sea Containers Limited then appealed to the Pensions Regulator Tribunal on 23 July 2007. The case has not yet reached a conclusion.

Source: TPR summary of publicly available case details

13 Prohibition of trustee

TPR made public the following details:

The Chairman of the Trustees of the Ericsson Employee Benefits Scheme misrepresented the pension benefits of executive members to Ericsson's senior management. These misrepresentations added £13.4 million to transfer values, increasing pension liabilities of the final salary scheme and the sponsoring employer.

The Chairman falsely claimed that executive members' benefits accrued at a 1/30th rate and were entitled to receive unreduced benefits from the age of 50. He presented this as an existing entitlement, rather than proposals requiring the parent company's approval, despite knowing that it would have a detrimental effect on the fund.

The Chairman also accepted for himself an exceptionally favourable second deferred pension, which potentially could affect other scheme members' benefits, without informing or seeking approval from other trustee directors.

After being alerted to the planned executive enhancements by a whistleblower's report, TPR immediately appointed an Independent Trustee to the Ericsson scheme to secure funds and began investigating the Trustee's conduct. As a result, planned executive transfers were cancelled and the Trustee's second pension was held pending investigation. Ericsson Ltd, the sponsoring employer, recovered two transfers worth £2.46 million which had already been paid.

The actions for which the Chairman was prohibited took place between April 2004 and June 2005. TPR was alerted by the Whistleblower's Report on 1 July 2005 and appointed an Independent Trustee on 7 July 2005.

Source: TPR summary of publicly available case details

4.19 The value of enforcement beyond protecting members of that particular scheme is in educating the market as to TPR's requirements and demonstrating that it will take action if it needs to protect members' benefits. To achieve this TPR needs to be transparent and consistent in its decision-making so that the market understands what the regulator deems unacceptable. However, the regulator must also ensure that the market does not interpret its decisions as standards. It must also respect the commercial confidentiality of its cases.

4.20 To ensure that TPR is clear about its regulatory requirements it publishes a range of information, including codes of practice, guidance, and regulatory statements. However, TPR has not routinely published the findings of its judgments or determinations because it wishes to minimise gaming of the system in areas where decisions are not clear cut. For example, if TPR sets a specific level of funding for a certain type of scheme it may encourage schemes that are funded well above this level to reduce their funding and possibly also encourage schemes to adopt similar investment strategies. If TPR sets a funding level for a particular scheme then this will take into account scheme specific data; TPR does not wish to be seen as setting a benchmark for other employers, for instance the investment strategy chosen. There is also the risk that it would set a new minimum funding requirement rather than a scheme specific funding requirement, as required by the legislation.

4.21 However, as the market matures TPR is now seeking to publish the findings of its determinations. At its board meeting in September 2007 TPR agreed a presumption towards publishing details of all its future determinations except in special circumstances. TPR will not, for example, publish details of individual scheme cases where it believes there are issues of commercial confidentiality or if it believes that the case will set precedents which could result in other schemes taking inappropriate decisions. However, as experience grows of the new statutory funding arrangements TPR may have scope to make greater use of case studies to support the other steps it takes to provide transparency to its regulatory expectations and decision-making.

Communications and visibility

4.22 To be able to create the right behaviours TPR has to get its messages across to a variety of stakeholders ranging from lay trustees to scheme administrators in some 84,000 schemes. It therefore needs to understand the different profiles and needs of the schemes and individuals it must reach and the modes of communication that are most appropriate. For example, getting its message across to a professional trustee in a multi billion pound money purchase scheme may require very different processes to communicating with a lay trustee in a small money purchase scheme.

4.23 TPR considers that it has active relations with the 1,600 largest schemes, but within the total of 84,000 schemes there are a large number of small schemes that TPR finds much more difficult to reach. TPR also has higher visibility with final salary than money purchase schemes. TPR has continued research commissioned by Opra in 2005 into the different forms of communication it might use for its different audiences. As a result of this it has put in place a strategy to use different forms of communication for different types of scheme. A new head of communications was appointed in early 2007 to coordinate TPR's communications strategy.

GLOSSARY

Actuary	An adviser on financial questions involving probabilities relating to mortality and other contingencies. In the UK, the term automatically includes Fellows of the Institute of Actuaries and of the Faculty of Actuaries.
Contract-based scheme	Contract-based schemes are schemes established by insurance companies, unit trust managers etc, where there is a contract between the member and the provider. Although employers may pay contributions to the provider and provide a payroll deduction service for the member's own contributions, they are not a party to the scheme. Some money purchase schemes are contract-based.
Corporate trustee (non-professional)	A company usually related to the employer (or the employer itself) set up to act as trustee for a scheme or a series of related or associated schemes.
Final salary pension scheme	Also known as a defined benefit scheme. Pensioners receive a pre-determined pension usually related to final salary. The employer is ultimately responsible for providing sufficient contributions to enable the pensions to be paid. In a minority of final salary schemes the pension is related to individual's career average earnings.
Money purchase pension scheme	Also known as a defined contribution scheme. These schemes pay a pension according to the value of the investment fund on retirement.
Goode Report	After serious irregularities in the Mirror Group Pension Scheme were found in 1991, the Pensions Law Review Committee, chaired by Professor Goode, produced a report in September 1993. Many of its recommendations were effected by the Pensions Act 1995.
Group Personal Pension	An arrangement made for the employees of a particular employer, or for a group of self-employed individuals, to participate in a personal pension scheme on a grouped basis. This is not a single scheme; merely a collective arrangement.
Hybrid schemes	Hybrid schemes have money purchase and final salary elements.
Member	A person who has been admitted to membership of a pension scheme and is entitled to benefits under the scheme.

Minimum Funding Requirement (MFR)	A requirement under section 56 of the Pensions Act 1995 that, under a prescribed set of actuarial assumptions, the actuarial value of assets of a defined benefit scheme should not be less than its actuarial liabilities. The Pensions Act 2004 requires the replacement of the MFR with more flexible scheme specific funding requirements.
Non-Departmental Public Body	A national or regional public body, operating independently of Ministers, but for which Ministers are ultimately responsible.
Notifiable Event	A notifiable event is a specified event that must be reported to the regulator. There are separate lists for trustees and employers.
Occupational Pension Scheme	A scheme organised by an employer or on behalf of a group of employers to provide pensions and/or other benefits for or in respect of one or more employees on leaving service or on death or retirement.
Personal Pension Scheme	A scheme approved under the Income and Corporation Taxes Act 1988 or the Finance Act 2004, under which an individual who is self employed, in non-pensionable employment, or employed but not a member of an occupational pension scheme, can make pension provision.
Pensions Simplification Review or the Pickering Review	In 2001 the Department for Work and Pensions announced a wide-ranging review of private pensions legislation with the aim of cutting red tape and reducing costs for occupational, personal and stakeholder schemes. The Review, led by Alan Pickering, reported in July 2002.
Professional trustee	An independent trustee not connected with the employer and not a scheme member. The trustee could be a corporate trustee company or an individual. A professional trustee provides trusteeship and trustee services to a number of unrelated and non-associated pension schemes.
Statutory Adviser	An adviser appointed by the trustees under section 47 of the Pensions Act 1995. This includes the scheme actuary and the scheme auditor.
Trust-based scheme	Final salary and some money purchase schemes are established as trusts, with trustees responsible for the governance of the scheme in accordance with the trust deed and the rules.
Trustee	An individual or company appointed to carry out the purposes of a trust in accordance with the provisions of the trust instrument and general principles of trust law.

Whistleblowing	The statutory duty imposed on the scheme actuary and scheme auditor by section 48 of the Pensions Act 1995 to advise TPR immediately in writing if they have reasonable cause to believe there is a material problem with an occupational pension scheme. Section 70 of the Pensions Act 2004 imposed a duty on trustees, employers, advisers and anyone involved in the administration of a scheme to whistleblow breaches of the law that are likely to be of material significance to the Regulator.
Winding Up	The process of terminating an occupational pension scheme, usually by applying the assets to the purchase of immediate annuities and deferred annuities for the beneficiaries, or by transferring the assets and liabilities to another pension scheme, in accordance with the scheme documentation or statute.
Work-based pension	Work-based pensions are those pensions whose arrangements are to some extent facilitated by the employer. The principal types are occupational, personal and stakeholder pensions.

APPENDIX ONE

Audit scope, criteria and methodology

Audit scope and criteria

1 TPR was established to take a risk-based approach to regulating work-based pension schemes and thereby to contribute to DWP's objective of increasing confidence in pensions. It replaced the former pensions regulator, Opra. Our report, *Opra: Tackling the risks to pension scheme members*, and the subsequent Public Accounts Committee report found that Opra had not been able to focus on the key risks to members of pension schemes. Specifically:

- The regulatory arrangements addressed only some of the risks to pensions provision;
- The regulator had not articulated clearly how its work would protect pension scheme members;
- The regulator had focused on reports that posed a low risk to scheme members; and
- There was limited information on the outcome of the regulator's work.

2 Subsequent to the National Audit Office and Public Accounts Committee reports Opra was replaced by TPR. TPR was established by the Pensions Act 2004 with the intention of taking a risk-based approach to regulating work-based pensions. It was given new powers with this aim in mind.

3 Against this background we have decided to evaluate the progress of TPR in regulating pensions. Since many of the pensions issues that the regulator faces are long term it is too early to use outcome-based information to evaluate the success of the regulator in meeting its statutory objectives. However, it is possible to evaluate whether TPR has put in place appropriate processes to take a risk-based approach to regulating pensions, and whether it has remedied the deficiencies in its predecessor's organisational design and approach to pensions regulation. We have therefore undertaken a review of risks in the pensions environment and TPR's approach to regulating for these risks.

4 There are three elements to our evaluation which form our audit criteria:

- Whether TPR's statutory framework and its interpretation of its objectives enables it to take an effective risk-based approach;
- Whether TPR has put in place appropriate processes for gathering data on and analysing risks; and
- Whether TPR is using its new powers appropriately and has developed strategies for mitigating the risks identified.

Audit methodology

5 Our evaluation was split into two stages. Stage one was an assessment of whether TPR is focused on the key risks prevailing in the pensions environment. Stage two was an assessment of TPR's regulatory approach and processes for mitigating these risks.

TPR's risk focus

6 To examine whether TPR is focused on the key risks we mapped out the main risks to members' benefits in the current pensions environment and assessed TPR's interpretation of its objectives against this. This allowed us to identify the appropriateness of TPR's interpretation of its statutory objectives as outlined in its medium term strategy and the appropriateness of its risk matrix (Figure 7). Our assessment was based on work carried out for us by KPMG, as well as our own analysis of third party research and interviews with TPR's main stakeholders.

TPR's regulatory approach to mitigating risk

7 To assess whether TPR's approach to pensions regulation is appropriate we examined each element of the regulator's strategy. For each element we i) identified the relevant principle of good regulation; ii) reviewed any relevant findings from the 2002 National Audit Office and 2003 PAC reports; iii) modelled the relevant processes within TPR and the extent to which they focused on the external problem; and iv) considered whether our interviews, international benchmarking, or research conducted by other organisations provided further evidence on TPR's processes and initial performance.

8 In the second stage we adopted an explicitly actor-based model; that is, following academic developments in the analysis of regulation,[20] we focused on the various actors in the world of work-based pensions and how TPR seeks to harness the behaviour of these actors to meet the statutory objectives.

9 Detailed information on each of the methodologies used to support the evaluation is given in paragraphs 10 to 21. Paragraphs 10 and 11 detail the methodologies we employed to understand the context of pensions regulation, paragraphs 12 to 21 detail the research we carried out to evaluate the effectiveness of TPR.

Methodologies to review the pensions environment

Review of the 2002 National Audit Office and 2003 PAC reports on Opra (Appendix 2)

10 The previous regulator Opra was reviewed by both the National Audit Office and Committee of Public Accounts in 2002-3. We evaluated the progress of the new regulator against the recommendations made. The main PAC findings and recommendations and our evaluation of TPR's progress is given in Appendix 2.

Review of pensions bodies in the UK and the background to the creation of TPR (Appendices 3 and 4)

11 To understand the context of pensions regulation and the role of TPR within the pensions environment we reviewed the roles and activities of the various bodies responsible for pensions in the UK (Appendix 3) and the background to the creation of TPR (Appendix 4).

Methodologies to review the effectiveness of TPR

Review of TPR research and documentation (Appendix 5)

12 TPR has carried out a range of research projects across a variety of subjects. We reviewed the coverage of its research and examined in detail the three projects that had a direct bearing on our audit. These were:

1 The annual governance survey

2 The annual perceptions tracker survey

3 The annual stakeholder survey

13 In order to be able to place reliance on TPR's research we examined the methodologies used, for example sample populations, sample sizes and conflicts of interest. More details on TPR's research are given in Appendix 5.

Review of third party research (Appendix 6)

14 We examined relevant external research covering the pensions environment and views on the impacts of TPR and its regulatory regime on scheme funding. The main sources of the research were businesses, professional bodies operating in the pensions sector, and academics. The research projects were selected on the basis of recommendations from the stakeholders we met and our own scanning of industry research. Appendix 6 gives details of the research.

International benchmarking (Appendix 7)

15 We benchmarked TPR's processes against those of the Irish and Dutch pensions regulators, the Pensions Board of Ireland and De Nederlandsche Bank (DNB) (Appendix 7). We also examined comparative statistics on pensions and their regulation produced by the Organisation for Economic Co-operation and Development.

Interviews with key individuals at TPR

16 To understand and evaluate TPR's regulatory processes we interviewed a number of TPR staff. The interviews were selected to cover all TPR's business units at a strategic and operational level. The selection was based on a map of TPR's organisational structure.

17 The interviews were unstructured and semi-structured interviews. In some cases we also observed the working practices of a team, for example the triage team, to understand in more detail the data flows and key decision making processes.

Stakeholder interviews

18 To gather and understand the views of TPR's key stakeholders we conducted unstructured and semi-structured interviews. Since TPR carry out an annual stakeholder survey we placed reliance on its work for quantitative information (more detail is at Appendix 6) and designed our interviews to gather qualitative evidence. The interviews enabled us to examine in detail third party views on TPR's regulatory activities. Our questions covered (inter alia) views on TPR's powers and objectives; its risk-based approach; and its education and guidance.

19 We interviewed the third parties listed in **Figure 14**.

Consultancy support from KPMG

20 We engaged KPMG to provide advice on detailed pensions issues, and to evaluate whether TPR's internal processes were consistent with a risk-based approach to regulating pensions. KPMG was asked to consider:

a Whether TPR has identified the key risks to final salary and money purchase schemes.

b The appropriateness and reliability of regulatory information that TPR is collecting, or plans to collect, to assess the risks identified in (a) above.

c The extent to which TPR's risk approach adequately informs its strategic priorities; work programmes; and resource allocation.

d Whether TPR has established, or is planning to establish, processes for intervening appropriately, based on its assessment of risk.

e Whether TPR is establishing an effective feedback loop to inform its risk-based approach.

21 KPMG's work was closely integrated with the other study methodologies and their findings underpin our overall evaluation of the regulator.

14 Third parties interviewed by the NAO

Bodies	Reason for selection
Association of Chartered Certified Accountants (ACCA) Faculty and Institute of Actuaries	Professional bodies
DWP	TPR's sponsoring department
Association of British Insurers (ABI) Confederation of British Industry (CBI) Investment Management Association (IMA) National Association of Pension Funds (NAPF) The Occupational Pensioners' Alliance (OPA) Society of Pension Consultants (SPC)	Representative bodies
Financial Services Authority (FSA) Government Actuary's Department (GAD) The Pensions Ombudsman The Pension Protection Fund (PPF) The Pensions Advisory Service (TPAS)	Other Pensions bodies
Simon Carne Chief Executive, CompAct Analysis	Performance measures
John Sadler	Former trustee of pension schemes
Teresa Sienkiewicz, Director KPMG	Pensions auditor
The Pensions Institute (PI) The Pensions Management Institute (PMI) The Pensions Policy Institute (PPI)	The three pensions institutes

Source: National Audit Office

APPENDIX TWO

Key Conclusions and Recommendations from the Committee of Public Accounts report, *Opra: Tackling the risks to pension scheme members*

This appendix details the key conclusions and recommendations from the Committee of Public Accounts report *Opra: Tackling the risks to pension scheme members* and the Government's response.[21] We have evaluated the progress made since our report and included our findings in bold following the main recommendations while reflecting the considerable changes to the pensions world since these reports were published.

Summary of conclusions and recommendations

Implementing the current regulatory framework

PAC conclusion (i): Opra should now agree objectives with the DWP, and adopt a strategy that addresses the most serious risks. As the DWP develop new pensions legislation, they should be clear as to what the legislation and the regulator are intended to achieve.

TPR has been given four strategic objectives:

1 **to protect the benefits under occupational pension schemes of, or in respect of, members of such schemes,**

2 **to protect the benefits under personal pension schemes of, or in respect of, members of such schemes,**

3 **to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund, and**

4 **to promote, and to improve understanding of, the good administration of work-based pension schemes.**

TPR has developed a risk-based approach for final salary schemes and is developing one for money purchase schemes.

PAC conclusion (ii): There are gaps in Opra's powers to demand information. The absence of an explicit power… does not mean that nothing can or should be done, however, and in such cases Opra should be seeking the information it needs on a voluntary basis.

The Pensions Act 2004 gave TPR a specific power to obtain information and obliged TPR to require all pension schemes to complete a scheme return at least once every three years.

PAC conclusion (iii): Opra has tried to address some of the gaps it perceives in the regulatory framework. For example, it sought to expand the information obtained by the Pension Schemes Registry from pension schemes, but the DWP's interpretation of the law was that Opra could not use the Registry for regulatory purposes. A register of pension schemes is of limited use without such basic details as trustee addresses and scheme auditors, and this position should not have been allowed to persist for so long. The DWP should work with Opra to find a way of obtaining information to gain a clearer overview of schemes as a whole, proposing legislative change if necessary.

TPR has developed a scheme return, in line with a new requirement in the Pensions Act 2004, that records information on all schemes. It has also been working with the Pension Protection Fund to cleanse the existing data.

Opra's focus on trivial breaches of pensions legislation

PAC conclusion (iv): In the five years to 2002 Opra has dealt with over 56,000 reported breaches relating to occupational pensions alone, and even more relating to personal pensions. Few of these reports reflected a material risk to scheme members. These large numbers reflect guidance to pensions professionals that all breaches should be reported rather than defining material breaches of the legislation. Opra should reduce the number of unimportant reports by issuing new guidance that conveys more clearly to pensions professionals what it considers to be a material breach.

In 2005 TPR issued a code of practice on reporting breaches and has appropriate processes to identify cases which require further action. The number of reports has now reduced to around 1,400 a year.

The development of a new kind of regulator

PAC conclusion (v): The Quinquennial Review of Opra has recommended that the DWP and Opra develop a new kind of regulator and draw up an implementation plan for the transition. The Review also recommends a new legislative framework. Opra and the DWP should prepare and publish an early implementation plan, showing how gaps in Opra's powers can be filled.

The new legislative framework was established by the Pensions Act 2004 and related statutory instruments. TPR has wider powers than Opra, designed to fill the gaps in Opra's powers and reflect TPR's objectives.

PAC conclusion (vi): Opra is seeking to differentiate between the risks to the members of different types of pension scheme. It is important that the regulator's actions are proportionate to the risks so that high risk schemes receive much greater scrutiny without unduly burdening schemes that are well run. The DWP and Opra should develop an approach that uses better information about individual schemes to categorise them, and enable the regulator to oversee the highest risk schemes closely and intervene promptly.

TPR has categorised schemes according to risk based on an assessment of the number of members affected by a risk and the severity of the risk. It has also broadened the sources and detail of information used by the model.

PAC conclusion (vii): It is important that the regulator should be able and willing to protect the interests of pension scheme members when companies merge or are taken over, and stamp out the "liberation" of pensions, where people are persuaded to sell their entitlement to their pension. The new regulator should have the flexibility to tackle these and similar developments as they emerge.

TPR has put in place arrangements to give 'clearance' to corporate transactions and or certain specified events in respect of their impact on pension scheme members. This voluntary process ensures that the regulator is content that appropriate mitigation is put in place and these events will not materially adversely affect members' benefits. TPR has also issued guidance to trustees regarding situations where the sponsoring employer effectively abandons its pension scheme; and on the information that should be provided to members where the employer seeks to induce them to transfer to a different pension arrangement.

PAC conclusion (viii): Many pension schemes have been closing to new members, reducing the benefits they provide, or are insufficiently funded to meet all members' entitlements if they are wound up. Many scheme members are concerned about the security of their retirement income and others may be making insufficient provision. Opra has little role at present in tackling these concerns…, but its expertise could be used to inform the future of pensions provision. A new regulator would be more effective with a wider-ranging role in advising the Government on pensions-related issues in general, such as the closure of schemes with insufficient assets to meet their commitments to all members, and educating employees and trustees on how to make pension choices.

Responsibility for financial education is split between a number of bodies: Financial Services Authority; Department for Work and Pensions (DWP); TPR; Department for Children, Schools and Families; Department for Innovation, Universities and Skills; HM Treasury; the Scottish Executive; the Welsh Assembly; the Basic Skills Agency and local authorities. TPR has a statutory power to educate under the Pensions Act 2004. This is targeted at trustees and those involved in the administration of work-based pension schemes, or advising the trustees or managers in relation to such schemes as to their operation. The Financial Services Authority has an objective to improve consumers' financial capability. The DWP is taking a lead on creating a climate in which people can make an informed choice about saving for retirement through pensions.

There is no body with overarching responsibility to advise on pensions matters although TPR do advise the DWP.

APPENDIX THREE

Key pensions bodies in the UK

This section provides key information on:

- The Department for Work and Pensions
- The Pensions Regulator Tribunal
- The Pension Protection Fund
- The Financial Assistance Scheme
- The Pensions Ombudsman and the Ombudsman for the Pension Protection Fund
- The Pensions Advisory Service
- The Financial Services Authority
- The Financial Ombudsman Service
- The Financial Services Compensation Scheme
- HM Revenue & Customs

The Department for Work and Pensions

The Department for Work and Pensions (DWP):

- is the sponsoring Department of a number of pensions bodies such as The Pensions Regulator, The Pensions Regulator Tribunal, The Pension Protection Fund, The Financial Assistance Scheme, The Pensions Ombudsman and the Ombudsman for the Pension Protection Fund, and The Pensions Advisory Service.
- offers a dedicated service for current and future pensioners. It provides state financial support to over 11 million pensioners delivered at a national and local level and in partnership with other organisations. It also helps people to plan and provide for retirement.
- develops pensions legislation such as the Pensions Act 2004 and Pensions Act 2007. As part of its policy work it has commissioned the Institutional Review of pensions bodies, the Deregulatory Review of pensions law and the Assets Review on improving the Financial Assistance Scheme within existing resources.

The Pensions Regulator Tribunal

An appeals body was established on 6 April 2005 to consider appeals from people subject to or affected by a determination of TPR. It has the power to return appeals to TPR with directions on how it should respond. Tribunal members are selected from a panel appointed by the Lord Chancellor. Previously determinations were made by Opra Board Members and other Board Members heard appeals.

The Pension Protection Fund

On 6 April 2005 the Pension Protection Fund (PPF), a Public Corporation, was established to:

- protect members of final salary occupational pension schemes which are winding up without sufficient funds to meet their liabilities. It provides compensation to the members of such schemes and is funded by levies on final salary occupational pension schemes; the assets of pension schemes that transfer into the PPF; and the returns it obtains from investing these funds.
- run the Fraud Compensation Fund which replaced the Pension Compensation Board (see footnote).[22]

Key facts about the PPF are listed below.

KEY FACTS

Pension Protection Fund

As at 30 June 2006 the PPF had 169 schemes with 110,000 members in assessment (being considered by PPF as to whether it should take responsibility for the schemes). It raised an initial levy of £138 million and an administrative levy of £12.6 million. The 2006-07 levy raised £324 million.

Financial Assistance Scheme

The Pensions Act 2004 made provisions for the Financial Assistance Scheme (FAS). The FAS was established in April 2005 and formally became operational on 1 September 2005. The FAS offers help to people who have lost out on their pension due to scheme under-funding or employer insolvency. The scheme is funded by the Government and has a cap of £26,000 per year per member. The estimated total cost of the scheme is £8 billion over 20 years.

On 6 June 2007 the DWP announced a review of the FAS to consider how it can be improved within its revised resources. It is expected to report by the end of the year.[23] On 16 July 2007, the Assets review produced its interim findings. It found that the present practice of each scheme purchasing annuities for its members (which were then topped up by the Government) may not offer the best use of these assets. Alternative approaches which could increase the value include the bulk purchase of annuities and pooling of assets in a single fund.[24]

The Pensions Ombudsman and the Ombudsman for the Pension Protection Fund

The Pensions Ombudsman was established to determine complaints and disputes of fact or law relating to occupational and personal pension schemes. The Ombudsman's decision is final and binding on all the parties to the complaint or dispute. It can be enforced in the Courts. His decision can only be challenged by appealing to the appropriate court on a point of law.

The Pensions Act 2004 created the Ombudsman for the Pension Protection Fund. The Ombudsman deals with referrals from the Pension Protection Fund and appeals against decisions made by the Financial Assistance Scheme. There is no charge for using either Ombudsman's services. The Pensions Ombudsman's office is funded by a levy on occupational pension schemes. In 2006-07 the Ombudsman's expenditure was £2.5million.[25]

The Pensions Advisory Service (TPAS)

TPAS is an independent voluntary organisation that provides free information and guidance on pension matters to members of the public. It also helps resolve disputes and complaints concerning private pension arrangements (company pensions, personal pensions and stakeholder pensions). TPAS is funded by a grant in aid from the DWP, which is recovered through the general levy on pension schems, and also relies on pensions professionals volunteering their time.

TPAS does not give investment advice nor does it get involved in disputes concerning state pensions, although it does provide general advice about state pension schemes. It was formerly known as the Occupational Pensions Advisory Service when its remit was restricted to occupational pensions. In 2006-07 TPAS piloted the idea of using workplace seminars on pensions and retirement, using trained volunteer advisers with the agreement of employers. TPAS is considering expanding its role to include trustees and employers.

The Financial Services Authority

The Financial Services Authority (FSA) regulates financial services firms. The FSA sets standards for insurance companies and ensures that senior management are "fit and proper". The FSA has no powers to regulate the administration of occupational pension schemes. It does however regulate the establishment, operation, sale, and winding up of personal pensions, including stakeholder schemes; and has taken a strategic lead in addressing the low financial capability among UK consumers. The NAO was commissioned to review the FSA and published its report in April 2007.[26]

The FSA is a private company limited by public guarantee, and funded by fees paid by the 30,000 firms that it regulates. The FSA's annual levies on the industry, which reflect the projected costs of regulation for that year, were £282 million in 2006-07. The FSA's net expenditure in 2005-06 was £266 million. It employs 2,600 staff, as of March 2007.

The FSA is responsible for appointing and removing the directors of the Financial Ombudsman Service (FOS), and ensuring that the FOS is at all times capable of exercising the functions conferred on it under the Financial Services and Markets Act 2000. The FSA approves the FOS's budget and makes and approves the rules of the FOS's complaints' jurisdiction.

The Financial Ombudsman Service (FOS)

An independent body, created by the Financial Services and Markets Act 2000, which became operational on 1 December 2001. The FOS is a public financial institution responsible for resolving individual disputes between consumers and financial services firms quickly and informally. Ombudsman decisions are not binding on consumers unless they choose to accept them; decisions are binding on firms. FOS is funded by a levy on financial services companies within its jurisdiction and from case fees, which become payable when chargeable cases are closed. Consumers do not pay to bring a complaint to the FOS.

The Financial Services Compensation Scheme (FSCS)

FSCS is an independent body, established under the Financial Services and Markets Act 2000 as the UK's compensation fund of last resort for customers of financial services firms. The FSCS can pay compensation to consumers if an authorised financial services firm is unable, or likely to be unable, to pay claims against it. This may include members of money purchase pension schemes. Its service is free to consumers. Authorised firms are those regulated by the UK's financial watchdog, the Financial Services Authority or previous financial regulators. The FSCS is funded by levies on authorised firms.

HM Revenue & Customs

Her Majesty's Revenue & Customs (HMRC)[27] seeks to ensure that schemes satisfy certain conditions in order to be eligible for tax purposes.

APPENDIX FOUR

Background to the creation of TPR

The replacement of Opra by TPR

TPR was established to replace Opra (the Occupational Pensions Regulatory Authority) the former pensions regulator. Opra had been established in 1996 in response to concerns about the security of pensions assets following irregularities in the Maxwell case. Some £440 million had been lost due to misappropriation, affecting 32,000 members of Maxwell Communications Corporation and Mirror Group Newspapers pension schemes. In response to this case the Pension Law Review Committee (the Goode Committee)[28] reported in September 1993 and made over 200 recommendations. Many of these recommendations were implemented through the Pensions Act 1995.

Opra was a regulator of certain aspects of pension scheme governance and was given powers to address some types of breaches of pensions legislation. There was a statutory duty for trustees, scheme actuaries and auditors to report specified breaches to Opra. Reports on other matters or by other people were voluntary. Opra drafted its own objectives which focused on reacting to reports of breaches of the Pensions Act. It felt obliged to give some attention to every reported breach[29] and as a result, Opra's work focused on reports that posed little risk to scheme members.

After five years of Opra's operations, the Department for Work and Pensions (DWP), Opra itself and many in the pensions sector recognised that reform of the pensions regime was necessary. This was in the light of Opra's experience and developments in the sector, including:

- the Pickering Report[30] called for the simplification of the regulatory framework for pensions in 2002. It recommended a change in pensions regulation and the establishment of a 'new kind of regulator' which would be outcome and customer-focused, transparent, proportionate and risk-based in its approach. Two further DWP reports and the NAO's report on Opra supported this recommendation;[31]
- concern over the security of pension scheme benefits. A number of sponsoring employers of final salary schemes became insolvent leaving pension schemes unable to meet their liabilities to their members; and
- concern over the scheme solvency standard. The Pensions Act 1995 had introduced a solvency standard known as the Minimum Funding Requirement (MFR). The MFR required the asset value of a scheme to be greater than the liabilities. However, the MFR did not guarantee sufficient assets to purchase annuities on wind up.

The Pensions Act 2004 brought in the following changes:

Reform of pensions law

- Introduction of a number of measures to provide greater flexibility and simplification in pension scheme administration.
- Replacement of the MFR for final salary occupational schemes with scheme specific funding requirements allowing schemes greater flexibility in developing funding strategies appropriate to their circumstances.

Establishment of new pensions bodies

- The Pensions Regulator (TPR) would take over Opra's responsibility for regulation of occupational pensions, and specific functions relating to personal pensions and stakeholder pensions. Like Opra, the Regulator would be funded by a levy on schemes. The Regulator was given a number of new functions and additional powers to carry out these functions.
- The Pension Protection Fund (PPF) would compensate members of final salary schemes whose employers become insolvent thereby leaving the pension scheme unable to meet its liabilities. The PPF is financed by a levy on all those schemes that could potentially benefit; the assets of pension schemes which transfer into the PPF; and the return it obtains from investing these funds.
- The Financial Assistance Scheme (FAS) would help current or former members of a final salary scheme that would not qualify for the PPF because they began winding up before 6 April 2005. The FAS is financed by government expenditure.

TPR and Opra

Figure 15 gives details of TPR and Opra expenditure and **Figure 16** gives non-financial information on the two organisations:

15 TPR and Opra expenditure

	TPR		Opra
TPR/Opra	2006-07 £m	2005-06 £m	2004-05 £m
Expenditure	31.9	27.4	22.8

Source: TPR/Opra reports and accounts

NOTES

1 Direct comparisons of the TPR and Opra's expenditure are not meaningful given the different functions of TPR and Opra. The Pensions Act 2004 required TPR to undertake a very different form of regulation to Opra, for example the requirements for scheme specific funding and TPR's clearance function.

2 Opra's expenditure figure excludes grants to The Pensions Advisory Service (TPAS) although Opra administered the funding of TPAS. Since April 2005 the Department for Work and Pensions has directly funded TPAS.

3 TPR's Corporate Plan for 2007-10 shows projected budgets peaking in 2007-08 and thereafter a slight decline. The projections are £32.5 million for 2007-08; £29.8 million for 2008-09; and £29.4 million for 2009-10. www.thepensionsregulator.gov.uk.

The Institutional Review

In June 2007 the Department for Work and Pensions' Institutional Review made three key recommendations:[32]

- A package of measures to underpin the close cooperation that already exists between the Pension Protection Fund and The Pensions Regulator.
- Implementing proposals to bolster cooperation and coordination between Financial Services Authority and The Pensions Regulator, particularly for defined contribution (money purchase) schemes.
- Combining the Pensions Ombudsman and Financial Ombudsman Service to create a pensions jurisdiction within the Financial Ombudsman Service.

The Department has stated that it intends to fully implement the Review's proposals and is working with the institutions and stakeholders to develop practical proposals to ensure the framework continues to support current and future pensioners.[33]

16 TPR and Opra non-financial information

	TPR	Opra
Status	Non-Departmental Public Body	Non-Departmental Public Body
Established	6 April 2005	1 April 1996
Board	One non-executive chair, five non-executive members, the chief executive and three executive directors	A Chairman and 9 other members A Chief Executive and 5 other members of Core Management Team attend Board meetings
Staff	The average number of TPR staff in 2005-06 was 288 and in 2006-07 was 325	About 260 other staff in 2004-05, including some 50 staff in the Pension Schemes Registry. The Registry collected the annual returns and levies from schemes and helped people trace their pension schemes

Source: TPR/Opra reports and accounts

APPENDIX FIVE

TPR's research results

This appendix summarises the findings of the main TPR research projects that we reviewed as part of our audit. The three main projects are:

1 The annual governance survey

2 The annual perceptions tracker survey

3 The annual stakeholder survey

1. The annual governance survey

TPR commissioned annual governance surveys in 2006 and 2007.[34] The surveys were designed to gain a broad understanding of current practice and governance among 'live' trust-based private sector pension schemes, both final salary and money purchase. TPR considers they help it to ensure that:

- its regulatory approach to governance is evidence-based and to identify emerging issues that might impact on members' benefits; and also
- it provides an independent evaluation of the usefulness and effectiveness of its activities intended to help strengthen governance.

In April 2007 TPR published its discussion paper on its future approach to governance, setting out its priorities and how it will take them forward. The 2006 governance survey findings helped establish these priorities, including initiatives on 'knowledge and understanding', 'conflicts of interest', 'monitoring of the employer covenant', 'relations with advisers', 'administration', 'processes for investment choice' and 'governance during wind-up'.

Methodology

The 2007 survey questions were largely the same as the previous years. Some questions were deleted, some slightly reworded and some new ones inserted. **Figure 17** gives details of the survey sample base.

Main Findings

Both surveys identified factors that support good governance (e.g. the size of the scheme, the extent of training, risk management processes and frequency of trustee meetings) and evaluated scheme performance against these factors.

The 2007 results showed evidence of improvement in three areas of governance on which TPR had focused most heavily during the last year: trustee knowledge and understanding, management of conflicts of interest, and monitoring the pension promise (the employer covenant). TPR expects to see some further improvements from its continuing emphasis on these three key areas and is continuing to tackle other priority areas on which there had been little improvement. It also recognised that there was still scope for much more improvement and that more needs to be done in respect of scheme governance overall.

The main findings were:

i The proportion of schemes offering no formal structured training during the past 12 months had fallen from 44 per cent to 34 per cent. Seventy per cent of schemes had at least one trustee using the Trustee toolkit e-learning tool. But one-third (34 per cent) of schemes had no training over the past year.

17 Annual Governance Tracker Survey Details

	2007 survey	2006 survey
Sample source	13,699 schemes from TPR database at 30 November 2006	15,272 schemes from the Pension Scheme Registry as at 31 March 2005
Screening interviews	1,298 trustees	1,235 trustees
Interviewed	500 trustees	500 trustees
Timing of Telephone interviews	February and March 2007	January – March 2006
Survey company	RSS Consulting/Critical Research	

Source: TPR

NOTE

Money purchase schemes with under 12 members and final salary schemes with under 5 members were excluded, some 80 per cent of all schemes but with one per cent of members. They were excluded since: many might be winding up; or all members might be trustees; or might be contract-based schemes which were incorrectly registered; and this kept the screening interviews and costs down.

ii Schemes did not experience significant difficulties in recruiting or retaining trustees although there had been considerable changes in the regulatory regime. Only a small minority of schemes reported that they had experienced difficulties in recruiting (12 per cent) or retaining (10 per cent) trustees over the past year, primarily due to increasing responsibilities and workload. TPR undertook to track this issue in future years.

iii Improving trustee understanding had generally not yet resulted in trustee boards being more confident in managing their schemes. Most scheme confidence measures had not moved significantly since 2006, from which TPR concluded that more work needed to be done to spread good practice.

iv Scheme confidence in managing conflicts of interest had increased significantly, and most considered they managed conflicts effectively. There had been a notable improvement since 2006 in formalising conflict management arrangements. This included having a specific policy in place and maintaining a conflicts of interest register. Even so, under a third of schemes had a register and only 35 per cent a policy. Also, because schemes that met less often and undertook less training reported fewer conflicts, there might be issues about identifying conflicts.

v Most final salary schemes had investigated the employer's financial standing in the past year.[35] The high level of activity in monitoring the employer covenant over the past year (79 per cent) was very encouraging given TPR's emphasis on this activity and Pensions Act 2004's scheme specific funding requirements.

vi Three-fifths of schemes had a process to identify the risks that could affect the scheme and its members. However, two-fifths of schemes did not have such a process in place, making it much harder to have effective internal controls (a Pensions Act 2004 requirement).

vii Open schemes showed greater improvement over the year compared to closed schemes, recording higher levels of governance activity in a number of areas and a significant increase in training. TPR undertook to explore the significance of the gap between these schemes.

2. The annual perceptions tracker survey

The annual perceptions tracker survey is designed to gather the views of those involved in the running of pension schemes on TPR's effectiveness. These cover pensions professionals and lay trustees but do not cover pension scheme members since the FSA has responsibility for their financial capability.

Methodology

The 2006 survey methodology was different from the previous year. Differences between the results of the two surveys are therefore indicative only. **Figure 18** gives details of the research samples used for the two perceptions tracker surveys to date. 2006 was the first full year of operation for TPR – the 2005 results also cover the final months of Opra.

Figure 19 reproduces the Executive Summary of the report on the Annual Perception Tracker Survey for 2006. The key highlights of the survey regarding perceptions of the Regulator, contact with TPR and overall performance follow.[36]

Perceptions of the Regulator: key highlights of the 2006 survey

Ninety four per cent believed they had a fair to good understanding of TPR and what it does. Seventy eight per cent believed that risk to members' benefits would increase if not for TPR. Seventy one per cent would recommend TPR as a source of information to others.

Knowledge and understanding: key highlights of the 2006 survey

Around two thirds of stakeholders felt they had a good knowledge of TPR and what it does. Ninety per cent felt they had a good knowledge of their own role and responsibilities. On specific issues (knowledge of final salary schemes, money purchase schemes, scheme governance and anti-avoidance), around 60 per cent had a good level of knowledge however, employers and in-house administrators notably lagged behind.

Contact with TPR: key highlights of the 2006 survey

Overall, the majority (63 per cent) were satisfied with the information they had received from TPR in the last 12 months but smaller schemes were less satisfied with the usefulness of the information.

Eighty eight per cent had been in contact with TPR in the last 12 months and 48 per cent in the last 3 months. The number one reason for contacting TPR for 5 of the 10 audiences researched was about a scheme return query. The other main reasons were general news updates and levy queries.

TPR's website was the primary point of contact and all audiences (49 per cent) considered it to be the most useful. The Trustee toolkit was also highly valued by lay trustees, pension scheme managers and in-house administrators.

The report found that TPR's Corporate Risk Management and Pension Administration and Governance teams were all perceived to be delivering extremely well in terms of usefulness (78 per cent and 77 per cent in 2006).

Overall performance: key highlights of the 2006 survey

TPR is rated highly as a trusted source of information **(Figure 20 on page 44)**. Respondents gave high approval ratings to guidance and codes of practice. 78 per cent of respondents felt that the risks to members' benefits would increase in the absence of TPR. When asked if the regulator's performance had improved, worsened or stayed the same over the last 12 months, 30 per cent felt that it had improved, 51 per cent that it had stayed the same, and 19 per cent that it had worsened.

Trustees and in-house pension managers are generally less knowledgeable about and satisfied with the regulator than their professional counterparts. TPR is looking to address this issue in the coming year.

18 Annual Perceptions Tracker Survey Details

	2006 survey	2005 survey
Pension scheme managers	75	0
Lay trustees	150	200
In-house administrators	75	0
In-house scheme managers/administrators	0	150
Actuaries, Auditors, IFA/Benefit consultants, Lawyers, Professional trustees, Third-party managers/administrators	300 (50 each)	301 (about 50 each)
Employers	150	150
Total	750	801
Timing of Telephone interviews	November 2006 to January 2007	3 November to 21 December 2005
Survey company	Illuminas	Ipsos MORI

Source: TPR

NOTE

Employers (Finance Directors/Pensions Directors) were included in the survey for the first time in 2005.

19 Executive Summary – Annual Perception Tracker Survey 2006

Key Measures

Overall knowledge of The Regulator	64 per cent
Overall performance of The Regulator	46 per cent
Overall usefulness of information	63 per cent

Overall The Regulator's performance and perceptions continued to be positive across all audiences.

Although not directly comparable, results were generally on par with or had improved on 2005 performance.

Strengths

Overall knowledge of TPR and its role was reasonably high across the whole market

Showed continued improving awareness differentiating it from Opra

78 per cent believed risks to members' benefits would increase without TPR

Website and e-learning were key contact points and performed strongly in terms of usefulness

Other contact points performed well, although some issues by reason for contact

Weaknesses

Some levels of dissatisfaction evident amongst those having contacted TPR with scheme return queries

In-house audiences were generally less knowledgeable and satisfied than their Professional counterparts

Opportunities

Some scope to lift performance amongst in-house audiences, particularly with regards to improving knowledge and understanding through information provision

Notably, needs of those with smaller schemes might not be adequately met

That said, the knowledge gap between in-house and professional audiences was likely to remain

Source: Annual Perception Survey 2006 (Illuminas) www.thepensionsregulator.gov.uk

20 Performance Indicators 2006

Performance Indicator	2006 per cent
The Regulator is a trusted source of information	78
Its actions are proportionate to the risk posed	43
The Regulator is focused on the most important risks to members' benefits	61
The Regulator works well with the Government to ensure that regulation is appropriate	35
The Regulator is proactive in reducing serious risks to members' benefits	55
The Regulator explains clearly why decisions affecting occupational pension schemes have been made	49
The Regulator is consistent in its approach to pension scheme regulation	51
Effectiveness of The Regulator in providing Codes of Practice	82
Effectiveness of The Regulator in providing guidance	73

Source: Annual Perception Survey 2006 (Illuminas)

NOTE

The figures show the percentage who agreed or strongly agreed with the statements above. The base was respondents who said they had a fairly good, good, or very good knowledge of The Regulator and what it does.

3. The annual stakeholder survey

Methodology

The first annual stakeholder survey was carried out in 2006 and involved: in depth interviews with 22 stakeholders from Government and other public bodies and Trade Associations and professional bodies; six face to face interviews each with one member of TPR management and one with three TPR managers; and two workshops with a total of 15 TPR staff.

Main Findings and Recommendations

The main findings covered TPR's overall performance and its current and future relations with stakeholders. Overall, the survey found that stakeholders were very happy with TPR's performance in its first 18 months of existence; the transition from Opra to TPR had been managed well; and there was a marked difference between Opra and TPR.

APPENDIX SIX

Review of independent pensions research

This appendix summarises the findings of independent research into trends in the pensions environment and the impact of the regulator on pension contributions in final salary schemes. We selected the research projects on the basis of recommendations from the stakeholders that we interviewed as part of our audit and our own scanning of research in the pensions sector.

A The Pensions Landscape

Volatility of pension scheme valuations

A number of research projects regularly evaluate the funding levels of pension schemes. These figures are often based on the FRS17 accounting measure.[37] The research indicates the following:

- Pension schemes of the FTSE 100 companies are in surplus overall using the FRS17 accounting measure.[38] This is after years in which there have been substantial financial deficits in many pension schemes. Factors include a rising equity market and falls in the prices of bonds which are used to measure pension scheme liabilities.
- Valuations of scheme funding are very volatile. For example there was a one day increase in pension deficits of £11 billion after market turmoil in China on 27 February 2007. The aggregate deficit in 2006-07 peaked at £50 billion in March 2007.
- There are still substantial deficits as measured by FRS17 in some schemes.

A study by the Association of Consulting Actuaries found that pension scheme deficits at small and medium enterprises[39] were generally proportionately larger. In August 2006 the study estimated that they had an average ongoing funding level of 69 per cent of liabilities at the last actuarial assessment.[40]

Growth in money purchase and contract-based schemes

There is evidence of a switch to money purchase schemes as demonstrated by the reports by Capita Hartshead, the National Association of Pension Funds, the Association of Consulting Actuaries, and Aon Consulting. The move is not just from final salary to money purchase schemes but also from trust-based money purchase schemes to contract-based Group Personal Pension schemes.

Capita Hartshead's 13th and 14th Pension Scheme Administration Surveys for 2006 and 2007 both reported final salary scheme closures and a continuing shift to money purchase schemes, and also more lately hybrid schemes.[41] The 2007 Survey found that 64 per cent of organisations in the sample had established money purchase arrangements. The latest annual survey by the National Association of Pension Funds found that 66 per cent of private sector employers with pension schemes now have a money purchase scheme.[42]

The Association of Consulting Actuaries 2006 Smaller Firms Pension Survey reported that as well as closing final salary schemes, there was evidence that lower-cost and more lightly regulated pension arrangements were displacing traditional money purchase schemes. Over 70 per cent of these smaller firms' schemes were closed to new members and over 40 per cent to new accruals.[43]

Aon's 2006 survey of money purchase schemes reported that for the first time that year, the percentage of contract-based schemes – Group Personal Pension Plans and Stakeholder pensions – (65 per cent) had exceeded the number of occupational trust-based schemes (35 per cent). The report found that this was further evidence of the trend away from trust-based schemes, which had seen the vast majority of new schemes being set up on a contract basis and an increasing number of trust-based money purchase schemes being wound up and transferred to contract-based arrangements. The survey also showed an increase from 2005 in the number of Group Personal Pensions (38 per cent) compared with Group Stakeholder schemes (27 per cent).[44]

Investment risk

Small and Medium Enterprises and Investment Risk

Research by Barclays Financial Planning found that 25 per cent of small and medium enterprise employers did not regularly review the performance of the investments made for their staff's pensions. Moreover, Just over half of these employers (52 per cent) said that they regularly update staff as to how their pension was doing.[45]

Investment risk to Individuals

In 2006 research by financial services provider MetLife estimated that 2.14 million people had not reviewed the performance of their personal pension schemes for over five years. Just over one in three (36 per cent) had reviewed them within the last year. Just over one in ten (11 per cent) said that they reviewed them one to two years ago, and an estimated 1.07 million two to three years ago.[46]

A survey by Baring Asset Management estimated 12 million people had never reviewed their pension plan and a further 1.37 million people had not reviewed their plans in the last five years. It also found that of the 52 per cent of people who had reviewed their pension plans, 41 per cent could not remember if they had chosen the default investment option for their pension scheme. 20 per cent of people had chosen the default option, while 39 per cent said they had chosen another option.[47]

The research also found that 49 per cent of people had not been advised on the appropriate asset allocation for their age and life stage and 39 per cent of people did not know if they had the appropriate asset allocation to suit their age and life stage.

B Impacts of the Regulator and the Regulatory regime on funding levels

Various independent research projects show that pensions contributions to final salary schemes have generally increased in 2006 and to a lesser extent in 2007. The Pensions Act 2004 scheme specific funding requirements were a major cause of the general increase of pensions contributions even before the legislation came into effect. The periods in which schemes were planning to eliminate deficits were generally becoming shorter in length and this was at least partly due to the Regulator and the scheme specific funding requirements in the Pensions Act 2004.

Capita Hartshead's 13th and 14th Pension Scheme Administration Surveys for 2006 and 2007[48] reported that over the last two years sponsoring companies of final salary schemes had decided to increase regular employer contributions (21 per cent and 41 per cent of schemes in 2007 and 2006) and to make special contributions (13 per cent and 42 per cent of schemes in 2007 and 2006). These were both designed to reduce funding deficits and future liabilities. A fifth of schemes had also reported increases in employee contributions in both years. Additionally, a further 17 per cent (16 per cent in 2006) of schemes had closed to new entrants. New choices were increasingly being offered; increased employee contributions, switching to Career Average, contracting in and salary sacrifice.

Mercer's second and third annual surveys of pension financial risk found that:

- almost 60 per cent of participants had made above-normal pension contributions in both years to fund accruing benefits; and
- by far the largest reasons for making above normal contributions given to the second survey were Scheme Specific Funding requirements (30 per cent) and general risk mitigation (25 per cent). Few companies made special contributions purely to reduce their Pension Protection Fund (PPF) levy or for tax reasons (7 per cent). By contrast the third survey reported that the drivers for funding were general pressure from trustees (50 per cent), strengthened mortality assumptions (31.7 per cent), general risk mitigation (30 per cent), PPF levy (28.3 per cent), corporate transaction (26.7 per cent), Pension Regulator triggers and tax (both 18.3 per cent).[49] Drivers for the contributions had evolved and many could be attributed to the regulatory regime introduced by the Pensions Act 2004.

Mercer's Statutory Funding Objective (SFO) valuations survey found that schemes have increased their funding targets by 8 per cent on average over the last two years, primarily to allow for expected increases in longevity. The report also found that schemes are planning to increase funding in their schemes to higher levels within shorter time periods: 94 per cent of schemes plan to achieve their new funding target in 10 years or less, compared to only 38 per cent two years ago. 10 per cent plan to settle the deficits almost immediately through extra contributions.[50]

Research by the Association of Consulting Actuaries found that 67 per cent of small and medium enterprises said they were considering further action to reduce any recovery period to 10 years or less in the light of the statement issued by the Regulator. Scheme deficits were a particular problem for small and medium enterprises with over a third of schemes unlikely to recover deficits within 10 years.[51]

The latest annual survey by the National Association of Pension Funds found that 27 per cent of final salary schemes anticipated being fully funded against new statutory funding targets within five years. 84 per cent expected to achieve this within 10 years.[52]

APPENDIX SEVEN

International benchmarking of pensions regulation

	UK	Netherlands	Ireland
Context/scale	Population 60.6 million and employed labour force 29 million.[1] 84,000 live occupational pension schemes at April 2007 (130,300 March 1999). Some 1,600 with over 1,000 members (over 80 per cent of total members), 1,400 final salary and hybrid schemes and some 200 money purchase schemes. Of the remaining schemes, some ninety per cent were money purchase schemes with some ten per cent being final salary or hybrid schemes. Most money purchase schemes had 2 to 4 members. There are growing numbers of money purchase schemes, in particular contract-based schemes.[5]	Population 16.3 million and an employed labour force 7.2 million Over 90 per cent of employees covered by occupational pension schemes. 563 live occupational pension schemes in 2007 (over a 1,000 in 1998).[2] Most are average salary. Schemes are generally much larger because the law encouraged the setting up of compulsory industry-wide schemes. Most pension schemes are company ones but their numbers are falling and most members are in industry-wide schemes. Money purchase schemes are unpopular.	Republic of Ireland population 4.2 million and workforce of around 2 million. There is pension coverage of some 55 per cent of the workforce, with 40 per cent of members being members of an occupational scheme only and 12 per cent with a personal pension only and under 3 per cent with both.[3] As at December 2006, there were nearly 93,000 live occupational pension schemes but 72 schemes had over 1,000 members – over 60 per cent of the Republic of Ireland's employees in pension schemes (454,000 out of 735,000). There were also 70,000 one-member schemes.[4]
Regulator/ Supervisor	The Pensions Regulator (TPR) from 6 April 2005. The Occupational Pensions Regulatory Authority (Opra) wound up on 5 April 2005. It was established 1 April 1996 and began handling cases on 6 April 1997.	De Nederlandsche Bank (DNB) from 30 October 2004 after merger with PVK. The Insurance Chamber (Verzekeringskamer), the insurers' supervisor, became supervisor of pension schemes in 1952. In 2001 its name changed to Pensions and Insurance Supervisory Authority (Pensioen en Verzekeringskamer or PVK).	The Pensions Board was established in 1991.

	UK	Netherlands	Ireland
Mission/ objectives	TPR – four statutory objectives: ■ to protect the benefits under occupational pension schemes of, or in respect of, members of such schemes; ■ to protect the benefits under personal pension schemes of, or in respect of, members of such schemes; ■ to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund; and ■ to promote, and to improve the understanding of, the good administration of work-based pension schemes. Wider remit than Opra.	DNB's mission is "…to maintain the stability of the financial system and of the institutions…in that system". For example, to ensure that a pension promise, once made, is actually fulfilled. PVK – financial stability; pension and insurance sectors	The Pensions Board's latest mission statement is: ■ to promote the security and protection of members of occupational pension schemes and contributors to Personal Retirement Savings Accounts[6], in accordance with the Pensions Act, 1990; ■ to promote the development of efficient national pensions structures; ■ to promote a level of participation in the national pensions system which enables all citizens to acquire an adequate retirement income; and ■ to provide information and authoritative and relevant parties in support of pension security, structures and participation.
Powers	TPR – more powers than Opra and more specific powers than DNB.	DNB – few but wide-ranging. There are four levels of supervision; depending on the risk. The supervisory activities are cumulative. PVK – few but wide ranging	The Board can prosecute trustees, actuaries and auditors of schemes and sponsoring employers for non-compliance with the Pensions Acts. The Pensions Acts impose fewer duties than the UK's 1995 Pension Act. In 2007 one-stop fines were introduced for less serious breaches of the Pensions Act. If the offender remedies the breach and pays the fine within 21 days, then there will be no prosecution. The Board promised a tougher approach to breaches.
Regulatory approach	TPR – risk-based, some pro-active elements, under development. Opra – not risk-based, re-active (some risk-based elements developed). TPR – mandatory reporting of specific notifiable events by trustees and employers. List of whistleblowers widened to include others involved in the running of pension schemes.	DNB – risk-based PVK – risk-based The law specifies a number of examples of situations in which an auditor or actuary is expected to notify PVK/DNB without delay.	The Board is not risk-based and is largely reactive. A wider range of advisers were legally required to report to the Pensions Board than to Opra. But these advisers only had to report material matters, defined as mainly actual or suspected fraud or material misappropriation. Other matters could be reported voluntarily. By 2001-02 the Board had received 48 reports since whistleblowing provisions were introduced in 1996 (10 compulsory and 38 voluntary), 15 of which were ongoing; a fraction of the reports received by Opra in five years.[7] A data cleansing exercise by the Board in 2004 discovered that about 30,000 registered (mainly one member) schemes, managed by life offices, had not been reported by their trustees as no longer being current.[8]

	UK	Netherlands	Ireland
Regulatory approach *continued*			During 2001 the Board monitored 16 large pensions administration services and confirmed significant improvements in service provided.[9] It recommended in 2006 that administrators should be registered and supervised and that service level agreements between trustees and administrators should be compulsory.[10]
Scheme Funding (final salary)	Final salary schemes (with a few exceptions) whose next valuations are in deficit must submit recovery plans to TPR for approval. TPR started dealing with this in 2006. The Pensions Act 2004 introduced scheme specific funding.	The Netherlands pensions regime has traditionally required higher solvency levels than the UK. PVK reacted to poor scheme returns after the millennium by issuing a policy rule on solvency in 2002 requiring short-term and medium-term plans. In 2004 the maximum recovery period was set at 15 years (December 2004 Bulletin). PVK and its successor DNB have established tighter solvency rules.	Final salary schemes (with a few exceptions) are required to submit to the Board actuarial funding certificates (AFCs) at 3 yearly intervals. In an AFC the scheme actuary has to certify whether, if the scheme had wound up at the effective date of the certificate, its assets would have been sufficient to meet its liabilities. An AFC must be submitted to the Board within nine months after its effective date. If the scheme could not meet its liabilities a funding proposal must be submitted to the Board. Trustee annual reports must include a statement from the actuary as to whether the scheme would have satisfied the Funding Standard at the last day of the reporting period. If the statement is negative the scheme must submit an AFC to the Board within 12 months of that date and submit a funding proposal. The Board can agree a later date for the scheme to meet the Funding Standard.
Education	The Pensions Act 2004 enables the regulator to provide information, education and assistance. This puts TPR's educational and related functions on a statutory basis. A higher standard of trustee knowledge is required. To meet this TPR set up the Trustee Toolkit, an e-learning website. Opra did not have a specific statutory duty to educate and inform. Nonetheless, it provided this service to increase compliance with pensions law and deal with misapprehension among businesses concerning stakeholder pensions. Its approach focused on compliance with the Pensions Act rather than more general good practice in scheme governance.	In the Netherlands pension trustees are professionals. DNB place more emphasis on integrity checks of managers and trustees.	The Board has a wider ranging education and training role than TPR. For example, the Board has prepared a trustee handbook, incorporating codes of practice for trustees. It registers suitable trustee training courses and course providers. It has to be satisfied with the course content and continued registration is dependent on the outcome of evaluations (Board staff attend courses as observers). It has also reviewed trusteeship. The Pensions Board has been running the National Pensions Awareness Campaign on behalf of their Government since 2003. The Board has reported that its consumer surveys have shown increases in the level of pension awareness from 60 per cent in 2003 to 87 per cent in 2006.[11]

	UK	Netherlands	Ireland
Advice	The NAO's report on Opra noted that "there is currently no body that has an overarching view of all aspects of work-based pensions, and the Pensions Simplification Review recommended that Opra's role be developed to fill this gap".[12] By contrast, the pensions regulators in the Republic of Ireland and the Netherlands have a statutory role of advising their Government on pensions regulation in general. TPR advises DWP on proposed pensions legislation from a regulatory perspective and is involved in reviewing and developing various EU Directives which impact on pensions.		

NOTES

1 The UK's figures are from the Office of National Statistics (www.statistics.gov.uk).

2 Netherlands figures from Statistics Netherlands (www.cbs.nl/en-GB/default.htm) and De Nedstrandsche Bank (www.statistics.dnb.nl).

3 Central Statistics Office Ireland, Population figures and Quarterly National Household Survey – Special Modules – Module on Pension Provision Quarter 4 2005.

4 The Pensions Board, Annual Report and Accounts 2006, July 2007. www.pensionsboard.ie.

5 TPR Corporate Plan 2007-10, May 2007.

6 These are intended to be low cost, flexible and portable pension products that should suit the needs of part-timers, other atypical workers and the lower paid generally. www.pensionsboard.ie.

7 NAO, Opra: *Tackling the risks to pension scheme members*, HC1262 Session 2001-2002, 6 November 2002.

8 The Pensions Board, Annual Report and Accounts 2004, 2005. www.pensionsboard.ie.

9 The Pensions Board, Annual Report and Accounts 2001, 2002. www.pensionsboard.ie.

10 *Report of The Pensions Board to The Minister for Social and Family Affairs on Trusteeship*, The Pensions Board, November 2006.

11 Overview of the Campaign/Pensions Board Bulletin 1: 2007.

12 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.

ENDNOTES

1 There are some 20 million memberships of private sector schemes, some individuals may be members of more than one scheme so the exact number of individuals with private sector pensions is unknown. This figure covers private sector pensions. Public sector pensions are excluded as they are not regulated by The Pensions Regulator. Source for 84,000 schemes figure - TPR.

2 For details of the PPF see Appendix 3.

3 The Occupational Pensions Regulatory Authority.

4 NAO, *Opra: Tackling the risks to pension scheme members*. (HC 1262 Session 2001-2002). *Opra: Tackling the Risks to Pension Scheme Members*, Committee of Public Accounts (Fifteenth Report 2002-03, HC 589).

5 These valuations are made using the Financial Reporting Standard 17 (FRS17) basis. The valuation of the assets of final salary pension schemes is normally made at market value and the liabilities on an actuarial basis. Previously both assets and liabilities were valued on an actuarial basis. Any surplus or deficit should appear in company accounts.

6 The pension entitlement of a final salary scheme is linked to the value of salary on retirement, whereas the pension entitlement of a money purchase scheme depends on the size of the investment fund on retirement. For more information see paragraphs 1.2-1.5.

7 TPR's research tracking the perceptions of its stakeholders is focused on pensions professionals, lay trustees and employers, rather than the individual members or beneficiaries of pension schemes who have no role in running pension schemes and because the responsibility for their financial capability rests with the FSA.

8 *Perceptions tracker, Presentation of findings*, The Pensions Regulator, April 2007.

9 The analysis utilises a dataset of 1,292 recovery plans submitted to TPR by the end of July 2007.

10 *The Purple Book, DB pensions universe risk profile*, Pension Protection Fund and The Pensions Regulator, December 2006.

11 *Recovery Plans, An initial analysis*, The Pensions Regulator, September 2007.

12 TPR, *Medium term strategy*, April 2006.

13 TPR, *Corporate Plan 2007-2010*, May 2007.

14 *A simpler way to better pensions*, Department for Work and Pensions, July 2002. Also known as the Pickering Review.

15 TPR's stakeholder research is focused on pensions professionals and lay trustees. It does not cover the members or beneficiaries of pension schemes as the FSA covers the financial capability of individuals. The research data was published in April 2007.

16 Mercer Human Resource Consulting, *SFO valuations – The first year's crop – Highlights*, April 2007.

17 The analysis utilises a dataset of 1,292 recovery plans submitted to TPR by the end of July 2007.

18 *The Purple Book, DB Pensions universe risk profile*, Pension Protection Fund and The Pensions Regulator, December 2006.

19 *Recovery Plans: An initial analysis*, The Pensions Regulator, September 2007.

20 For example, the work of Julia Black at the Centre for the Analysis of Risk and Regulation at the London School of Economics.

21 *Opra: Tackling the Risks to Pension Scheme Members,* Committee of Public Accounts (Fifteenth Report 2002-03, HC 589). Treasury Minute on the Tenth to the Twelfth and the Fourteenth to the Fifteenth Reports from the Committee of Public Accounts 2002-2003, Cm 5802 June 2003.

22 The Pensions Compensation Scheme, administered by the Pensions Compensation Board, was introduced in 1997 to help occupational schemes which have suffered a reduction in value of their assets as a result of dishonesty and where the sponsoring employer is insolvent. The Pension Protection Fund took over its functions in September 2005.

23 DWP Press Release, *Financial Assistance Scheme – Review of Assets*, 28 March 2007.

24 DWP Press Release, – *Hain welcomes interim findings of Assets Review,* 16 July 2007.

25 *Annual Report of the Pensions Ombudsman 2006-07*, July 2006.

26 National Audit Office, *The Financial Services Authority, A Review under Section 12 of the Financial Services and Markets Act 2000*, April 2007.

27 In 2005 the Inland Revenue merged with Customs & Excise to form Her Majesty's Revenue & Customs.

28 *Pensions Law Reform, the Report of the Pensions Law Review Committee* – Chairman Roy Goode, CM 2342, HMSO, September 1993. Also known as the Goode Report.

29 Opra received 56,000 reports in its first five years since it started handling cases from 1997-98 to 2001-02. NAO, *Opra: Tackling the risks to pension scheme members* (HC 1262 Session 2001-2002).

30 *A simpler way to better pensions*, Department for Work and Pensions, July 2002. Also known as the Pickering Review.

31 *The Quinquennial Review of Opra*, December 2002. Green Paper, *Simplicity, security and choice: working and saving for retirement*, June 2003.

32 *A Review of Pensions Institutions*, Paul Thornton, An independent report to the Department for Work and Pensions, June 2007.

33 Department for Work and Pensions, Press Release *Minister welcomes publication of institutional review,* 5 June 2007.

34 TPR, *Occupational pension scheme governance* – A report on the 2007 scheme governance survey, RS Consulting John Leston and Margaret Watmough, July 2007. TPR, *Occupational pension scheme governance* – A report on the 2006 scheme governance survey, RS Consulting John Leston and Margaret Watmough, September 2006.

35 Eighty one per cent reviewed the sponsoring employer's accounts, 77 per cent the credit rating and the analysis underlying it and 62 per cent the Business Plan.

36 *Perceptions tracker, Presentation of findings*, The Pensions Regulator, April 2007.

37 FRS17 is an accounting measure and is not necessarily indicative of the funding on a statutory measurement basis. Examples of research that used this measure are: *Pension schemes now in surplus FTSE 100 pension deficit falls to zero*, Deloitte, 22 May 2007. *UK pension schemes move into surplus for first time in over five years*, Aon Consulting, 18 May 2007. *Over £100 billion wiped off fund deficits in four years*, Aon Consulting 1 June 2007.

38 As at 27 September 2007 Deloitte reported that the total surplus had risen to £22 billion in FTSE 100 companies under the FRS17 measure. *Pension schemes gain dispite market turmoil*, Deloitte 27 September 2007.

39 Defined as firms with up to 250 staff.

40 Association of Consulting Actuaries, *2006 Smaller Firms Pension Survey*, August 2006.

41 Capita Hartshead *13th Pension Scheme Administration Survey 2006* (Underline Marketing and Research). Capita Hartshead *14th Pension Scheme Administration Survey 2007*, May 2007.

42 NAPF Press Release, *New NAPF survey shows one-third of salary-related schemes still open,* 21 February 2007.

43 Association of Consulting Actuaries, 2006 *Smaller Firms Pension Survey*, August 2006. The survey found that open defined benefit schemes (in the main final salary based) were, for example, very rare compared to previous surveys of the sector stretching back to 1996.

44 Aon Quarterly Newsletter Compass, issue 39, *Design of Defined Contribution schemes – results of our latest survey*, Autumn 2006.

45 Press Release, *One quarter of employers do not review performance of staff pensions*, Barclays, 28 March 2007.

46 Press Release, *An estimated 8.5 million people have multiple pension plans but many are rarely checked for performance*, MetLife, December 2006.

47 Barings Press Release, *12 million people fail to review their pension plan,* June 2007.

48 Capita Hartshead *13th Pension Scheme Administration Survey 2006* (Underline Marketing and Research). Capita Hartshead *14th Pension Scheme Administration Survey 2007*, May 2007.

49 Mercer Human Resource Consulting and the Association of Corporate Treasurers, *Survey of Pension Financial Risk (2nd Annual Survey)*, July 2006. Mercer Human Resource Consulting and the Association of Corporate Treasurers, *Survey of Pension Financial Risk (3rd Annual Survey)*, July 2007.

50 Mercer Human Resource Consulting, *SFO Valuations – The first year's crop – Highlights*, April 2007.

51 Association of Consulting Actuaries, *2006 Smaller Firms Pension Survey*, August 2006.

52 NAPF Press Release, *New NAPF survey shows one-third of salary-related schemes still open,* 21 February 2007.

Printed in the UK for the Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office
5674185 10/07 7333

Design and Production by
NAO Marketing & Communications Team
DP Ref: 7590VA

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