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*Buck Consultants' response to the Pensions  
Regulator's discussion paper on the  
governance of work-based pension schemes*

*July 2007*

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## **Introduction and executive summary – the need to strike a balance**

We are pleased to have this opportunity to comment on the discussion paper on the governance of work-based pension schemes. Governance is certainly the issue of the moment, reflecting its importance in the effort to ensure that employees' pension rights are adequately protected and correctly administered. The discussion paper is a useful reminder of the issues involved.

One of the problems with this subject is the potential breadth of it. As illustrated by the discussion paper, it encompasses a wide range of different areas, which ideally should fit together in respect of a scheme or arrangement to provide an aligned and seamless governance regime.

Although most of these items will already have been dealt with quite adequately by many, it is likely that they will have been developed at least to some extent in isolation, which creates the risk of gaps. We therefore welcome the Regulator's attempt to tie together in one 'umbrella' paper all the various strands of the governance universe.

However, this attempt to bring the various strands together also creates difficulties with sponsors and trustees/managers of schemes. It is sometimes difficult to convince these parties that a further review of their current practice is in fact necessary, especially at this juncture, when they have spent a considerable amount of time and money on getting new processes up and running over the past few years, in response to specific legislative and regulatory initiatives – and this at a time when cost pressures from pensions have never been higher.

We have considerable sympathy with that reaction, but whether or not that sympathy is widely felt, it is a fact that there is general resistance to spending any more time and money on reviewing governance issues. This resistance needs to be recognised and taken account of, because history has shown that sponsors of schemes are perfectly able and willing to reduce or even withdraw their support for work-based pension arrangements, if pushed too far.

So, the aim should be to review and, if necessary, improve governance, while taking sponsors and managers/trustees along as willing participants. This implies a need to restrict the extent of any required changes to a reasonable level, and to justify them as being appropriate and proportionate – in short, to strike a balance between the need to protect member interests and the cost of doing so.

We are encouraged by the Regulator's stated recognition of this. However, different parties will have different ideas about where that balance should be struck; indeed, the balance may legitimately be struck at different levels for different schemes. The discussion paper seeks further ideas for adapting regulatory practice to smaller schemes. This is a difficult subject to address generically, and any attempt to be prescriptive will result in 'cliff edges' where similar schemes face different regulatory scrutiny as a result of being on one side or the other of an arbitrary boundary. The emphasis should therefore be on setting principles for trustees and managers to apply in using their own judgement, backed by a Regulator that is sympathetic to

the circumstances of particular cases and supportive of genuine attempts to apply those principles in a proportionate way. There are issues where we would disagree with the balance proposed in the discussion paper, and we identify those below.

We also note the Regulator's intention to improve governance standards in key areas. However, we would urge caution in the proposed use of numerical targets, based upon survey results, as the method by which success in this objective is to be measured. Many would argue that a culture of judging progress by the use of numerical targets in other areas of public life has resulted in a focus on quantitative issues, to the detriment of the qualitative ones. Our concern is that such an approach here may not properly recognise the circumstances of individual schemes, and reduce governance regulation to a very blunt instrument.

## **Specific comments**

### **Chapter 4: The Pensions Regulator's regulatory priorities for governance**

If the confidence and support of scheme sponsors is to be maintained, it is important that true costs are recognised. Whilst we agree with the underlying theme of paragraph 4.5, in respect of the benefits of an effective governance regime, we do not agree that the true costs can be dismissed in a generic statement such as appears here and which also appears, unchallenged, in other documents from the Regulator, for example trustee knowledge and understanding.

This discussion paper and related documents to which it refers imply that a review of the governance procedures should be undertaken – and should occur on a regular basis thereafter. We have no quarrel with such an approach – it is a good discipline and in any case is required in respect of risk controls; however, it is wrong to suggest that costs will necessarily be low. They are likely to be significant, involving varying amounts of professional assistance, initially and over time.

In addition, the correlation between this expenditure, and the costs likely to be saved by avoiding problems as a result, will differ from scheme to scheme. A scheme that has already expended considerable time and effort on this issue in the past will gain less from each pound expended in a governance review than a scheme that has been neglected.

### **Chapter 6: Conflicts of interest**

We agree the broad message behind this section, about the importance of identifying and managing conflicts of interest. We also recognise the difficulties that can be caused for a trustee body if a key trustee with significant relevant experience and knowledge has to absent themselves at a crucial point.

However, it is not the potential conflict that is the problem, but the failure to manage it if and when it arises. We should not dissuade, for example, key company personnel from being trustees per se; an informed decision should be taken on a case-by-case basis.

We are concerned that the section may be driving schemes towards the appointment of professional trustees. Whilst in some cases that may be entirely correct – and in some, desirable – many trustee bodies work perfectly well staffed entirely with enthusiastic and committed non-professionals. There is a significant cost implication in having a professional trustee, and we would not like to see schemes being pressurised into spending money where the value from that expenditure is not clear.

## **Chapter 7: Monitoring of employer covenant**

This is an area that presents considerable challenges for a number of trustee boards. Although clearly a very important requirement, it is one that can have enormous cost implications if a detailed ongoing monitoring programme is to be pursued.

This is an area where proportionality is a key issue; we are aware of new services coming to the market to help trustees discharge their responsibilities at a more affordable cost. We note that the discussion paper has no new initiatives to offer here, but we recommend that trustees be given suitable freedom to decide their own level of monitoring. If that means that, in a small number of cases, important employer covenant issues go undetected, trustees should have reassurance from the Regulator that if their level of covenant monitoring is not inappropriate to their particular circumstances (perhaps taking account of advice received or which should reasonably have been sought), the Regulator will not penalise them.

## **Chapter 8: Relations with advisers**

We agree that some trustees may welcome the publication of a pertinent collection of questions to ask advisers, in order to help them assess those advisers' suitability. However, care must be taken when devising the questions to ensure that they do not imply that only one answer would be correct in all circumstances; trustees should be trusted to interpret the answers they receive and assess for themselves whether they are acceptable, or whether further enquiry or action is needed as a result.

As for conflicts of interest for advisers advising more than one party, our experience is that such situations are becoming better understood by both advisers and their clients, with separate advisers being appointed in potentially sensitive situations. We do not see this as an area where prescriptive guidelines are right, because it is not an area where one approach can be universally applied.

## **Chapter 9: Administration (of trust-based schemes)**

The comments in this section, whilst recognising on the one hand the differences between DB and DC administration requirements and issues, nevertheless seem to mix them by taking generic lines. If relevant conclusions and proposals are to be produced, there should be a clear focus on the right type of scheme to which a comment is addressed. It would also be helpful to any debate for the term 'administration' to be clearly defined, since it means different things to different people.

Whilst it is of course absolutely correct to drive for the highest standards, 'administration' is difficult to do flawlessly; there is a cost issue here, but many schemes are reluctant to pay the full market rate of a full 'Rolls Royce standard' administration service.

If a number of schemes show a reluctance to change their third-party administration provider, it is likely to be a reflection of the upheaval and cost that such change inevitably generates; it is understandable therefore that schemes do not undertake this process lightly. Although it may be good practice to review the appointment of administration providers on a regular basis, the focus may be more effective if directed towards reviewing performance and working together to eliminate examples of 'below par' performance. Part of any such review should be a frank and open discussion about the true costs of providing the required service, supported by an acknowledgement from the Regulator of the need for a proportionate approach.

## **Chapter 11: Governance during wind-up**

We are fully supportive of the movement to speed up the winding-up processes of occupational schemes. However, there are usually a number of parties involved in the process, and the issues presented by differing standards and turnaround times amongst those parties, some of whom are not subject to the Regulator's regulatory remit, should not be overlooked.

There is also one particular issue that should be addressed. The process of reconciliation of Guaranteed Minimum Pensions in respect of schemes that were contracted out on a defined benefits basis prior to April 1997 is one of the most common delaying factors. If progress is to be made, the DWP/HMRC must take positive steps to improve the situation, for example by allowing wider margins of error on reconciliation of what are often in practice very small amounts of benefit.

## **Chapter 12: Contract-based schemes**

Since the FSA is already looking after many aspects of these schemes, we agree that there should be no governance overlap with the Pensions Regulator.

The temptation to become involved in the terms of arrangements offered by employers should be resisted. There should be no regulatory intervention in the terms under which any arrangement is offered or in the practical workings of such an arrangement (unless such a term or practice is unfair to the member who cannot avoid being affected by it, such as unnecessarily delayed payments of member contributions to the provider). Whilst we accept that research clearly shows the benefits of having fewer fund choices on offer to members, regulatory intervention to set an arbitrary limit on the maximum number of fund choices that can be offered would be wrong.

We agree that employer involvement in some areas can be useful, but that this is an issue for individual employers and their arrangements to consider – it should not be a regulatory issue. We do not think that management committees are necessarily the universal panacea that they are considered to be in some circles. The concept is often not well thought-out in terms of the purpose of these committees, and there is a real danger that this lack of clarity of purpose will lead to problems. Although we generally prefer to avoid regulatory intervention where it is not

strictly necessary, this is an area where some guidance on the purpose of such committees (if a committee is deemed appropriate) might be helpful to focus minds.

We are sceptical of the alleged benefits of the 'kite marking' initiative. Although this may sound superficially attractive, there is a very real danger that the interpretation of what the kite mark is actually conveying will also be superficial, leading to members drawing inappropriate conclusions when comparing the relative merits of different arrangements.

## **Conclusion**

In conclusion, we believe that care must be taken to consider the likely effects of any new regulatory initiatives – especially costs. We are pleased that the Regulator appears to have taken this point on board, but would urge that each new proposal be specifically reviewed against this benchmark.

We hope that our comments make a useful contribution to the debate. We would be happy to comment further, either generally or on specific issues, if it would be of assistance.

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