



The Pensions Regulator and Governance: Right skills and right processes

December 2009

Radically revised draft guidance on internal controls is the first move in the Pensions Regulator's new campaign to improve pension scheme governance and administration.

The consultation paper accepts that, after three years of trying, the Regulator has not managed to persuade many smaller schemes to adopt the processes that deliver good risk management. The new guidance is particularly addressed to these schemes – and sets them a demanding target.

Over the next few months the governance campaign will also lead to:

- revised scope guidance for TKU,
- a new and user friendly e-learning programme on risk management,
- new guidance on record keeping, and
- updated guidance on winding up a scheme.

For the Regulator, the key to good governance is for the trustee body to have the right skills and to operate the right processes.

In place of its current high level guidance on internal controls the Regulator is proposing much more explicit requirements. It is aiming at small schemes in particular after survey and case-work evidence that many do not have sound controls.

The message on compliance is stern: schemes with deficient controls will be expected to comply promptly with the new guidance when it is issued. Trustees will be asked to "comply or explain".

Internal controls is not an easy topic for the Regulator. All trustees have a statutory obligation to set up controls that are "adequate" to ensure their scheme runs according to its rules and the law. The obligation is the same regardless of size. Unsurprisingly, small schemes with limited resources tend to have the greatest need to raise their game.

The only minor concession to size is in the Regulator's code of practice: "Smaller schemes may require less formalised controls than more complex larger schemes, but regardless of size, key risk areas will still need to be adequately controlled". If the 45 page draft guidance represents a "less formalised" approach, it is still going to make considerable demands on the financial and management resources available to small schemes.

The guidance concentrates on seven areas of risk. The first is about right skills, the rest about right processes:

- inadequate trustee knowledge and understanding,
- conflict of interest,
- poor record keeping,
- deterioration in the employer's covenant,
- investment risk, and
- weak retirement processes.

Under each heading the guidance explains:

- why the risk area is important,
- what behaviours the Regulator expects trustees to adopt, and
- what controls it asks them to set up.

The guidelines are practical and, although not exhaustive, will act as a checklist and catalyst as trustees develop controls that address the risks of their particular scheme.

The most detailed section is about understanding and monitoring the employer's covenant, including finding out which employers have funding obligations to the scheme and recognising that they can include former employers. Due diligence in this area can be as much legal as financial.

The guidance has a number of useful tables:

- specific risks in each of the seven areas with controls to tackle them,
- a risk scoring model and a traffic light system to distinguish risks that can be accepted from those that need to be managed and those that must be avoided,
- a self appraisal form for trustees, and
- a risk register.

As in the current guidance, the principle behind all the detail is the risk management cycle of identifying risks, developing controls to address them, implementing those controls and evaluating their success in practice. And then starting the cycle again.

The code of practice on internal controls will not be changing.

The consultation period ends on 1 March 2010.

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