Regulation of work-based DC pension schemes

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There are a number of different bodies involved in the regulation of work-based defined contribution (DC) pensions. DWP and HM Treasury are responsible for policy and regulations and, in addition, there are three regulatory bodies: The Pensions Regulator (TPR), the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA).

In July 2012, the National Audit Office expressed concern that there was no single body leading on regulating DC schemes, setting objectives or measuring performance. In April 2013, the Work and Pensions Committee expressed concern about "regulatory gaps" and recommended that the Government reassess the case for establishing a single regulator.

In its triennial review of pension bodies published in January 2014, the Government said that the question of whether there should be a single regulator was the one that attracted the widest range of responses. There was no consensus about the need for change or what the most appropriate way forward might be (although there was consensus that in the short-term, the focus should be on auto-enrolment). The Government concluded that while a single-regulator might be able to do more to ensure consistency of approach, it would give rise to a different set of issues. It concluded that there was no structure that was clearly and unambiguously better than the one already in place. However, significant changes in pensions were in prospect with the implementation of auto enrolment, and the issue would need to be reviewed at a later date.

This note aims to provide an overview of the regulatory arrangements for work-based DC pensions and the arguments for having one regulator or two.

Measures to improve the quality of work-based DC pensions within the existing regulatory framework are discussed in more detail in Library Note SN 6956 *Improving outcomes for DC pension savers* (September 2014).

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1 The regulatory framework

There are a number of different bodies involved in the regulation of work-based DC pensions. DWP and HM Treasury are responsible for policy and regulations and, in addition, there are three regulatory bodies: The Pensions Regulator (TPR), the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). In January 2014, DWP explained the role of each as follows:

> 26. TPR is the specialist regulator for workplace pensions, but it is not the only regulatory body to operate in this area. The relevant responsibilities of TPR, FCA and PRA are set out below:
>
> > *TPR* - Regulates workplace pension schemes, including administration and employer duties, trust and trustee activity, and the funding of DB schemes. This includes the administration of work-based personal pension schemes.
> >
> > *FCA* - Regulates financial advice given to employees in relation to personal pensions and is the prudential supervisor of smaller financial services firms, including financial advisors.
> >
> > *PRA* - Regulates large financial services organisations, such as banks and insurance companies, including the protection of policy holders.[1]

A memorandum of understanding published in April 2013 explained the respective roles and responsibilities of TPR and the FCA as follows:

> **Roles and responsibilities of the FCA and TPR**
>
> 5. The FCA is responsible for regulating the standards of conduct in retail and wholesale, financial markets and for supervising the infrastructure that supports those markets. The FCA also has responsibility for the prudential regulation of firms that are not regulated by the Prudential Regulation Authority (PRA).The FCA's single strategic objective is to ensure that the markets for financial services function well. This objective is underpinned by three operational objectives which are: securing an appropriate degree of protection for consumers; protecting and enhancing the integrity of the UK financial system; and promoting effective competition in the interests of

[1] DWP, *Triennial review of pension bodies*, January 2014

consumers in the market for financial services. In respect of pension schemes, the FCA:

- regulates firms that provide, promote, market, advise on or sell personal, including stakeholder, pensions and annuities – occupational trust based pension schemes are specifically excluded from its remit

- regulates the establishment, operation and winding-up of personal pension schemes

- supervises the prudential risks of firms that are not regulated by the PRA who provide personal, including stakeholder, pensions

- has an indirect interest in occupational trust-based pension schemes because it regulates firms which provide investments and investment services to occupational trust-based pension schemes (eg investment managers, insurers selling insurance-based pension products, advice given to scheme trustees on investments)

- is accountable, in a number of significant respects, for the Financial Ombudsman Service (FOS), which handles complaints about personal, including stakeholder, pensions – FOS shares this complaints handling role with the Pensions Ombudsman and

- is responsible under FSMA, in conjunction with the PRA, for the Financial Services Compensation Scheme, which covers, amongst other things, the liabilities of FCA-authorised firms which provide or advise on personal, including stakeholder, pensions.

6. TPR is the statutory regulator of work-based pensions. TPR's objectives are protecting the benefits of members of occupational pension schemes; protecting the benefits of members of personal pension schemes where direct payment arrangements are in place; reducing the risk of situations arising that may lead to compensation being payable under the Pension Protection Fund (PPF); promoting, and improving understanding of, the good administration of work-based pension schemes; and to maximise employer compliance with employer duties and employer safeguards under the *Pensions Act 2008.* TPR:

- regulates occupational pension schemes, including their funding, governance and administration

- regulates certain aspects, including administration, of work-based personal pension schemes

- provides information, education and assistance in relation to work-based pension schemes to:

- those involved in the governance and administration of work-based pensions

- those who advise trustees and managers on the operation of work-based pensions

- statutory employers of work-based schemes and people who advise them.[2]

[2] *MOU between the Financial Conduct Authority and the Pensions Regulator,* April 2013

Regarding work-based personal pension schemes, for which regulatory responsibility is shared, it said:

> **Regulation of work-based personal pension schemes**
>
> 10. The FCA and TPR have shared interest and regulatory responsibilities in relation to work-based personal pension schemes. These are personal and stakeholder pension schemes where contributions are paid into them through direct payment arrangements, i.e. the mechanism of employer payments, whether these payments are employer contributions or are employee contributions deducted from pay.
>
> 11. The FCA's main areas of responsibility in respect of these schemes are in relation to regulation of financial advice given to employees and the supervision of providers that are not regulated by the PRA. TPR's main areas of responsibilities in respect of these schemes are promoting good administration of the schemes, the requirements on employers around the payment of contributions into the schemes, and to maximise compliance with employer duties and safeguards under the *Pensions Act 2008.*
>
> 12. In the event of significant risks to members of work-based personal pension schemes, the regulators will co-ordinate or inform each other where appropriate regarding any substantive action to be taken.
>
> 13. Where significant risks are identified which relate across a provider's personal pension portfolio (i.e. where the risks involve both individual personal pensions and work-based personal pension schemes), the FCA is more likely to lead on this area since the risks may affect matters outside of TPR's jurisdiction.
>
> 14. Where there are problems which primarily relate to group personal pensions then the regulators will liaise. TPR is more likely to take the lead where there are issues which relate to the employer.
>
> 15 If the matter is particularly serious there may be occasions where both regulators will seek to address issues. This would be done following discussions between the regulators as to how this can be done in a complementary manner.[3]

TPR and FCA have been developing arrangements for working more closely together. In January 2013, TPR published an analysis of the extent to which the six principles that were at the heart of its regulatory approach were present in the FCA's regulatory regime. It found a "high level of alignment between the FCA's rules and regulatory expectations for providers and our regulatory expectations on scheme quality (as defined by the DC principles and features). Furthermore, it said that although the two regulators took different approaches to regulation, the activities underpinning them were "broadly analogous." [4]

The approach taken by the two main regulators is discussed in more detail below.

1.1 The Pensions Regulator

The Pensions Regulator (TPR) was introduced under the *Pensions Act 2004.* It was part of a package of measures, including the establishment of the Pension Protection Fund intended to provide better protection for pension benefits following a number of high profile cases in

[3] *Memorandum of Understanding between TPR and FCA*, 2013

[4] TPR, *Initial analysis of the regulator's defined contribution quality features in FSA regulation of work-based personal pensions*, January 2013; TPR, *Strategy for regulating defined contribution pension schemes*, October 2013, p12 and 14

which defined benefit schemes wound up underfunded on the insolvency of the employer.[5] TPR replaced the Occupational Pensions Regulatory Authority (OPRA). In contrast to OPRA, which had focused on “high volumes of relatively low value reports and breaches”, TPR was intended to take a “risk-focused and proactive approach.”[6] It would also have a significantly wider range of powers and responsibilities than OPRA.[7] For example, OPRA had no powers to act against employers’ attempts to avoid meeting their pensions obligations and no duty to do so, TPR was provided with a regulatory ‘tool kit’, including powers to sanction.[8]

TPR’s objectives, set out in section 5 of the *Pensions Act 2004,* as amended, are:

- to protect the benefits of members of occupational pension schemes
- to protect the benefits of members of personal pension schemes (where there is a direct payment arrangement)
- to promote, and to improve understanding of the good administration of work-based pension schemes
- to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund (PPF)
- to maximise employer compliance with employer duties and the employment safeguards introduced by the *Pensions Act 2008.*[9]

In its September 2013 report, the Office of Fair Trading (OFT) outlined TPR’s roles and powers as follows:

> **The role and powers of the Pensions Regulator**
>
> 3.28 In exercising its statutory functions, TPR has the main objective of protecting benefits under work based pensions schemes and promoting good administration. TPR fulfils this duty by issuing codes and guidance on aspects of work place pension schemes (although its ability to act formally when guidance is not sufficient is greater when the problem is with a trust based scheme). The regulator has a range of options for dealing with trust based schemes. It has powers to:
>
> • issue notices and orders
>
> • recover unpaid contributions
>
> • prohibit trustees who are not fit and proper
>
> • impose fines where it finds a breach (for example, where the security of a member’s benefits has been jeopardised), and
>
> • prosecute certain offences in the criminal courts.

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[5] See, for example, HC Deb, 2 March 2004 c759 [Andrew Smith]; For more on the background see Library Research Paper RP 4/18 *Pensions Bill (Bill 57 2003/04);* Library Note SN 4638 *Pensions Regulator: Powers to protect pension benefits* (March 2013)

[6] DWP, *Simplicity, security and choice, working and saving for retirement: action on occupational pensions, June 2003,* Cm 5835

[7] The Pensions Regulator, ‘Annual report and accounts, 2005-06’, p3

[8] NAO, *The Pensions Regulator: Progress in establishing its new regulatory approach*, HC 1035, Session 2006-07, 26 October 2007; DWP, *Simplicity, security and choice. Working and saving for retirement. Action on occupational pensions*, 2003

[9] *Pensions Act 2004*, section 5; The Pensions Regulator – our objectives

3.29 The regulator aims to regulate according to the risks in the market by 'educating, enabling and enforcing' through codes, guidance and support wherever possible, and using enforcement action only as a last resort. When the regulator does enforce against breaches of behaviour, principles and statutory responsibilities set out in its Code of Practice, it generally does on a case-by-case basis. TPR is bound by legislation and does not have rule making ability, as the FCA does.[10]

TPR has increased its focus on DC schemes in recent years. In 2007, the National Audit Office (NAO) noted that TPR had initially focussed on final salary pension schemes, "where the need for action was most urgent and the risks to members greatest."[11] In 2012, it said that TPR was increasing the proportion of resources devoted to DC schemes:

9. The Pensions Regulator is increasing the proportion of its resources devoted to regulating defined contribution schemes. Active membership of defined contribution schemes overtook membership of defined benefit schemes in 2005. The Pensions Regulator estimates that defined contribution regulation accounted for 22 per cent of its activities in 2011-12, which is around £6.7 million, and expects to devote more resources to defined contribution schemes as the market grows with automatic enrolment, from October 2012. The Pensions Regulator has considerable skills and experience in regulating trust-based schemes. However, the market is changing and a majority of defined contribution scheme members now belong to contract-based schemes, so a different regulatory approach may be needed. The Pensions Regulator has now developed a plan – the Defined Contribution Programme – to deal with these changes. The Pensions Regulator's approach to resourcing is to flexibly match skills to operational activity including use of secondees, and, in February 2012, it began an internal analysis of the skills it needs in this area. It has not, however, commissioned an independent review of its capability since it was established.[12]

TPR has produced regulatory guidance for trustees of occupational defined contribution trust-based schemes and *Code of practice 13 Governance and administration of occupational defined contribution trust-based pension schemes.* Its strategy for regulation defined contribution pension schemes explains that six principles frame its regulatory approach:

Principle 1: Essential characteristics. Schemes are designed to be durable, fair and deliver good outcomes for members;

Principle 2: Establishing governance. A comprehensive scheme governance framework is established at set up, with clear accountabilities and responsibilities agreed and made transparent;

Principle 3: People. Those accountable for scheme decisions and activity understand their duties and are fit and proper to carry them out;

Principle 4: Ongoing governance and monitoring. Schemes benefit from effective governance and monitoring through their full life-cycle;

Principle 5: Administration. Schemes are well administered with timely, accurate and comprehensive process and records;

[10] OFT, *Defined contribution workplace pension market study,* September 2013; See Library Note SN 4368 *The Pensions Regulator: Powers to protect pension benefits* (March 2013)

[11] NAO, *The Pensions Regulator: Progress in establishing its new regulatory approach*, HC 1035, October 2007

[12] NAO, *The Pensions Regulator. Regulating defined contribution schemes*, July 2012

Principle 6: Communications to members. Communication is essential to make informed decisions about their retirement savings.

1.2 The Financial Conduct Authority

The Financial Conduct Authority (FCA) was set up under the *Financial Services Act 2012.* Library Research Paper RP 12/08 *Financial Services Bill* explains the developments which led up to this. Briefly:

- *The Financial Services Act 1986* introduced a two tier regulatory system. Departmental responsibility initially rested with the Department for Trade and Industry, but was later transferred to the Treasury. Many of the powers under the Act were delegated to a sole top-tier regulator, the Securities and Investments Board (SIB). Below SIB were a number of self-regulating organisations (initially five, later three). These SROs were funded and in part managed by the investment firms that belonged to them. The system was subject to criticism from the outset: with the industry unhappy with the costs it imposed and outsiders arguing the structure favoured the industry over than investors.

- This two-tier regulatory structure was replaced by the *Financial Services and Markets Act 2000.* At the head of the system was a renamed SIB, now called the Financial Services Authority (FSA), whose sphere of responsibility has widened significantly during its subsequent history, for example, assuming responsibility for general insurance matters and mortgages. Self-regulation was replaced by a 'new and fully statutory system.'

- The *Financial Services Act 2012* replaced that FCA with the Financial Conduct Authority. The FCA also took over the regulation of consumer credit from the Office of Fair Trading (OFT).

In a speech in June 2011, the interim managing director of the conduct business unit at the FCA, Margaret Cole, outlined some of the challenges facing the new body. This included the fact that it would be regulating the provision of financial services to an immense range of customers:

> Over the past 20 years we have seen large-scale mis-selling of financial products to UK consumers – personal pensions, mortgage endowments, split-capital trusts and payment protection insurance. There is a chasm between the fair treatment consumers should be entitled to expect from our financial services industry and what a series of bitter experiences have shown that many of them actually get. […]
>
> This is what I think can be referred to as a 'burning platform' for change. Change for both the industry and the regulator. The industry has the challenge of developing a culture of responsibility. For the regulator these cases highlight the importance of spotting problems earlier and the need for robust early intervention.
>
> The scale of the challenge is large. The FCA will regulate the provision of financial services to an immense range of consumers – from retail consumers taking out a mortgage or buying a pension – through to major organisations raising capital in the international markets.[13]

The FCA would have new objectives and duties:

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[13] 'The Financial Conduct Authority – a new regulatory approach', speech by Margaret Cole, June 2011; See also FSA, *The Financial Conduct Authority: Approach to Regulation,* June 2011

> It will have a single strategic objective – to protect and enhance confidence in the UK financial system. This will be supported by three operational objectives: securing an appropriate degree of consumer protection; promoting efficiency and choice; and, protecting and enhancing the integrity of the UK financial system. It will also have duties to promote competition and to address financial crime.
>
> This statutory framework will provide the FCA with a far-reaching mandate. It will involve a wide range of analysis and activity such as:
>
> - a commitment to understanding consumers' needs and behaviour;
> - examining pricing to establish whether a market is competitive;
> - ensuring the resilience of the trading infrastructure; and,
> - it will also involve the FCA taking the initiative in the regulation of competition in the financial services market.[14]

The main challenge for the new body would be to "devise new approaches which prevent consumer detriment in the first place, not just focusing on ensuring redress after the fact."[15]

In its Business Plan for 2014/15, the FCA said the roll-out of auto-enrolment brought new challenges:

> The roll-out of automatic enrolment brings a new set of challenges to the UK pensions market. We are taking an active role in developing new policy to protect pension savers, working closely with both the Department for Work and Pensions and The Pensions Regulator (TPR).
>
> We lead on the regulation of personal pensions, including work-based personal pensions, with TPR leading on occupational pensions. We continue to have a joined-up approach and look for opportunities to work together that are of benefit to the industry, firms and consumers.
>
> We are continuing our work on the individual personal pensions market, including Self-Invested Personal Pensions (SIPPs). We have increased our focus on the market for retirement products, such as annuities, with the launch of a major competition study and work to tackle poor sales practices.[16]

Key activities for 2014/15 would include:

> **Effective due diligence for retail investment advice**
>
> We will look at whether investment advisers are carrying out appropriate due diligence to ensure that consumers are sold suitable products and services.
>
> **Sales practices at retirement**
>
> We will carry out work looking at sales practices that consumers experience at retirement, the results of which will feed into our wider work on retirement income products.
>
> **Fair treatment of long-standing customers in life insurance**

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[14] Ibid
[15] Ibid
[16] FCA *Business Plan 2014/15*

> We will assess whether firms are operating historic (often termed 'legacy' or 'heritage') products in a fair way and whether they have adopted strategies that exploit existing customers. […][17]

The FCA is in the process of developing new standards for the "guidance guarantee" that the Government has committed itself to introducing for people with DC pension savings approaching retirement. This is in connection with its plans to allow individuals flexibility from April 2015 about when and how to access their DC pension saving from age 55, subject to their marginal rate of income tax. HM Treasury said in March 2014:

> 3.13 The government does not believe it would be appropriate for the organisations which will deliver the guidance to be subject to FCA authorisation and regulation in respect of this activity. However, to ensure the conduct of these organisations is subject to appropriate standards, **the government will bring forward legislation to establish a new, separate FCA standards regime, and to give the FCA, as the expert conduct regulator, the appropriate duties and powers to set standards and monitor compliance.** The Treasury will be responsible for designating the guidance delivery partners that will be subject to the standards regime, and will ultimately be responsible for ensuring that remedial action is undertaken on the basis of any recommendations about their conduct from the FCA. The government will also bring forward legislation to clarify that the delivery partners designated by the Treasury as official providers of the guidance, and subject to the standards, will not need to be authorised in respect of this activity. This approach will help prevent unscrupulous firms passing themselves off as providers of guaranteed guidance.[18]

The guidance guarantee is to be legislated for in the *Pension Schemes Bill 2014/15.* It is discussed in more detail in Library Research Paper RP 14/44 Pension Schemes Bill (21 August 2014) (section 2.13).

2 Should there be a single regulator for DC pensions?

2.1 Analysis of the current framework

In July 2012, the NAO said shared regulatory responsibilities meant there were no overarching objectives and no common framework for making evidence-based assessments of risks to members:

- **There is no single public body leading on the regulation of defined contribution schemes and ultimately accountable for the delivery of regulatory objectives**.[…]
- **The shared regulatory responsibilities require The Pensions Regulator to work together with the Financial Services Authority, but there are no overarching objectives and no common framework across the regulatory system for making evidence-based assessments of risks to members.**[…]
- **Because there is insufficient clarity regarding regulatory objectives and risk assessment, it is unclear whether The Pensions Regulator has an appropriate level and range of powers.** […]
- **Outcomes for defined contribution scheme members can vary considerably, even if factors outside the control of regulation are held constant, such as investment performance and contribution levels.**[…]

[17] Ibid p19

[18] HM Treasury, Freedom and choice in pensions, Cm 8835, March 2014

- **Effective governance arrangements can help protect members, but they can vary considerably across different schemes.**[…]

- **The impact of regulation in reducing unwarranted variation in outcomes for pension scheme members is unclear**.[19]

It concluded that:

> Four public bodies participate in a senior level group on defined contribution pensions (the Department for Work and Pensions, The Pensions Regulator, the Treasury and the Financial Services Authority), but there is no single body leading on regulating schemes, setting objectives or measuring performance. The lack of a joined-up approach also means that there is insufficient basic information available about the market, such as definite numbers of scheme members or the levels of fees and charges they face.[20]

In April 2013, the Work and Pensions Committee recommended that the Government reassess the case for establishing one body with sole responsibility for regulating workplace pensions.

> ***115. We remain concerned about current regulatory gaps and the potential for further gaps to arise as a result of three regulators having a role to play. We believe that it is necessary for a single regulatory body to have sufficient powers to ensure that all members of workplace pension schemes are given adequate and consistent protection. We therefore recommend that the Government reassess the case for establishing one body with sole responsibility for regulating workplace pensions.***[21]

The report of the OFT's defined contribution workplace pension market study indicated a potential weakness in the regulatory arrangements for contract-based schemes - TPR's options for intervention were limited and the FCA might not be best suited for tackling value for money because many of the relevant risks resulted less from specific actions in the market than from inaction over a prolonged period:

> **The role and powers of the Pensions Regulator**
>
> 3.28 In exercising its statutory functions, TPR has the main objective of protecting benefits under work based pensions schemes and promoting good administration. TPR fulfils this duty by issuing codes and guidance on aspects of work place pension schemes (although its ability to act formally when guidance is not sufficient is greater when the problem is with a trust based scheme). The regulator has a range of options for dealing with trust based schemes. It has powers to:
>
> • issue notices and orders
>
> • recover unpaid contributions
>
> • prohibit trustees who are not fit and proper
>
> • impose fines where it finds a breach (for example, where the security of a member's benefits has been jeopardised), and

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[19] NAO, *The Pensions Regulator. Regulating defined contribution pension schemes*, July 2012, pp8-9

[20] NAO, *Regulating defined contribution schemes*, July 2012

[21] Work and Pensions Committee, *Improving governance and best practice in workplace pensions*, 6th Report of 2012/13, April 2013, para 104-115

• prosecute certain offences in the criminal courts.

3.29 The regulator aims to regulate according to the risks in the market by 'educating, enabling and enforcing' through codes, guidance and support wherever possible, and using enforcement action only as a last resort. When the regulator does enforce against breaches of behaviour, principles and statutory responsibilities set out in its Code of Practice, it generally does on a case-by-case basis. TPR is bound by legislation and does not have rule making ability, as the FCA does.

3.30 TPR has fewer options to intervene directly on contract based pension schemes, where regulatory responsibilities are shared with the FCA. In 2012, the National Audit Office (NAO) looked at the regulation of DC pension schemes and found that TPR may not have been given sufficient statutory powers to fulfil its objectives regarding contract based schemes.

The role and powers of the Financial Conduct Authority

3.31 The FCA regulates firms and individuals that promote, arrange, or provide contract based DC schemes. The FCA can investigate the conduct of registered firms, enforce rules and regulations, and make new rules as required. In doing so, firms authorised by the FCA must adhere to the FCA's TCF [Treating Customers Fairly] principles which requires firms to focus on six outcomes for consumers.

3.32 The FCA may take enforcement action where firms have failed to comply with their rules (for example, around Conduct of Business) or their Principles (for example, around Treating Customers Fairly which requires firms to focus on six outcomes for consumers), particularly where there is a significant risk to consumers. The FCA regulates through regular assessments of firms' conduct and varies the intensity of these assessments based on the nature and size of the firm. Many of the investment products used by DC schemes will be regulated by the FCA. The FCA is also responsible for the prudential regulation of financial services firms, like investment managers, which are not supervised by the Prudential Regulation Authority (PRA).

3.33 In principle, the FCA could take action against a poor value for money contract based DC pension under the treating customers fairly outcomes. However, to the extent that regulation may be directed at specific actions of companies, or at specific developments in the market, it may not be best suited for tackling value for money. That is because, as noted throughout this report, many of the value for money risks we have identified result less from specific actions in the market, and more from the consequences of inaction over a prolonged period of time. We do however note that under the FCA, there is a pension team in place and greater scope to taking a proactive approach to ensure DC workplace pensions provide ongoing value for money for savers.

The role of the Prudential Regulation Authority

3.34The PRA is a subsidiary of the Bank of England responsible for the prudential regulation and supervision of deposit takers, insurers and major investment firms. The objective of the PRA is to promote the safety and soundness of PRA-authorised persons, including firms active in the pensions market. The companies that provide contract and bundled trust based schemes tend to be regulated by the PRA which safeguards against systemic risk in the market. Providers of master trusts are not currently subject to prudential regulation.[22]

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[22] OFT, *Defined contribution workplace pension market study*, September 2013

The OFT made a number of recommendations for the short-term, which included:

- Dealing with old and/or high charging schemes;
- Dealing with issues with small trust based schemes;
- Improving governance
- Improving the quality of information available on costs and charges; and
- Preventing future risks of detriment.[23]

It was confident that these recommendations would address the risks of consumer detriment arising in the short to medium term in the context of automatic enrolment. For the longer term, it set out a number of principles for how the DC workplace pension market should evolve. These principles, which it argued should inform future regulatory and policy initiatives, related to: scale; the alignment of incentives; robust independent governance; flexibility to move assets and change administration; and simplicity and switching.[24]

2.2 The Government's approach

Response to Work and Pensions Committee

In its response to the Work and Pensions Committee, the Government said it believed the overall regulatory architecture was sound and there would also be issues around where boundary lines were drawn. However, the effectiveness of interventions in response to particular issues would need to be tested as the market evolved and regulators would increasingly need to work closer together:

> As the successful performance of DC pension schemes relies on well supervised investments, a role which is firmly in the FCA's remit, there will always be a need for them to regulate elements of contract-based pension schemes. Consequently there will be a number of regulators for pensions focussing on different elements and there will always be issues around where boundary lines are drawn.
>
> We believe that the overall regulatory architecture is sound and, given there will always be a boundary between the roles of the FCA and TPR, there are no current plans to fundamentally change the arrangements for regulating contract-based pension schemes at this time. However, as the market is evolving in response to automatic enrolment, it will always be necessary to test whether the regulatory interventions in relation to particular issues are effective. We are clear that the regulators should work increasingly closer together to ensure that risks are jointly managed and members are protected regardless of how their pension is provided. This is being achieved through a variety of means.
>
> First, the regulators have already published a memorandum of understanding setting out how they will co-operate, co-ordinate and exchange information, to improve collaboration on guidance, policy and standards. This memorandum will support the regulators' work in ensuring their objectives are as closely aligned as possible to deliver appropriate regulatory outcomes for all pension scheme members.
>
> Second, we recognise that it is necessary to better articulate the existing regulatory framework and the working relationships between regulators to ensure that the regulatory and legislative frameworks for governance of both trust-based and contract-

[23]

[24] Ibid, para 1.50

based DC provision are consistent and sufficiently robust. As such, in the Autumn, the FCA and TPR will be jointly publishing a document that sets out how the regulation of work-based personal pensions operates.

DWP, TPR, FCA / Prudential Regulation Authority and HMT meet regularly at both working level and through a senior level forum and have a programme of work to ensure that areas of common interest are identified and regularly considered. In order to further strengthen the links between them, the regulators have also worked together on developing the principles of a good pension scheme.

The FCA is updating its pensions strategy which directs pensions activity both within its central policy team and also within its wider supervisory teams which have expertise in pensions. This strategy will inform FCA's business plan which is planned to be published in Spring 2014. The FCA's new approach to supervision has a focus on industry-wide themes and in January, the FSA launched a thematic review of the pension annuities market. We anticipate that there will be further thematic reviews in relation to pensions including joint working with TPR.[25]

Triennial review of pension bodies

In its triennial review of pension bodies published in January 2014, the Government said that although in principle, the remits of TPR, the FCA and PRA were distinct, there were grey areas at the boundaries:

> 27. In principle, the remits of these organisations are distinct, but in practice there are some grey areas at the boundary. Perhaps more importantly, different aspects of regulation – and thus different regulators – may apply to different aspects of a single scheme's activity. An employer offering a DC scheme, for example, will be regulated by TPR, but will typically do so by contracting with an insurance company which is regulated by FCA and PRA, often through a financial advisor also regulated by FCA.
>
> 28. There are differences of philosophy as well as differences of remit. For workplace pensions, the employer plays a central role which has no equivalent in financial services more generally. Members of pension schemes have some of the characteristics of customers of financial service providers, but not others. And there is a fundamental difference between entities for which the provision of financial services is their core business and those for which pension provision is an employee benefit which is incidental to their primary business purpose.[26]

It said the question of whether there should be a single regulator was the one that attracted the widest range of responses. For example:

> 34. The TUC focused on the problems it perceives the current structures create:
>
> > Our view is that the nature of the relationship between TPR and the FCA and PRA fundamentally inhibits TPR from achieving its statutory objectives.
>
> It drew particular attention to master trusts and decumulation as critical areas where the different roles and approaches of TPR and FCA created regulatory risks and opportunities for gaming.
>
> > 35. EEF, representing employers in manufacturing industry, was among those arguing for the continuation of specialist workplace pension regulation: Independent regulation is required from an organisation which can understand the

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[25] *Improving governance and best practice in workplace pensions: Government Response to the Committee's Sixth Report of Session 2012-13,* Work and Pensions Committee
[26] DWP, *Triennial Review of Pension Bodies,* January 2014

particular demands occupational pensions place on employers and the unique nature of the benefits which occupational pensions bring. […] Knowledge therefore of the unique nature of occupational pensions and their importance to employers and workers can only be maintained we believe with a regulator devoted to the area.

36. The Institute of Chartered Accountants supported a single approach to regulation from a slightly different perspective:

> We consider that a single regulatory framework is essential because, over their working lives, people are likely to accumulate pension savings in both trust-based and contract-based arrangements, and it is not helpful from the perspective of the individual member for these arrangements to be subject to two different regimes.

37. Scottish Widows, by contrast, considered that there should be a clear separation:

> While all the bodies being reviewed perform valuable functions, we believe that it would be preferable to have a single regulator for all DC pension schemes, which would most naturally be the FCA.[27]

The Government said there was no consensus about the way forward, although there was general agreement that in the short-term the focus should be on delivering the policy of auto-enrolment:

38. There is thus no consensus about the need for change or about what the most appropriate way forward might be. It is important to recognise that there is a question of substance and a question of timing: is there a better regulatory structure, and if there is, is now the right time to be making changes.

39. There is more agreement on the second question than the first. As already noted at paragraph 14 above, TPR is having to manage a number of major changes, and there is widespread recognition that there should be no distraction from the successful implementation of automatic enrolment in particular. The ABI, which is one of the organisations which has been critical of the current regulatory division of labour, was clear in its evidence:

> Ensuring automatic enrolment is a success must be the priority and this requires, in part, stability in the regulatory framework. Therefore we believe that 'continued delivery' is the best course of action for the bodies under review.

40. Financial services regulation has itself been through recent major changes, with FCA and PRA existing in their current form only since April 2013; further significant disruption before those changes have become firmly embedded does not appear immediately attractive.

41. Nor is it the case that there is a clear alternative which would work better. Conceptually, there are three possible basic models:

- A single regulator covering all aspects of workplace pensions
- A single financial services regulator, including pensions
- Two (or more) specialised bodies, though not necessarily with the boundaries falling as they do now.

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[27] Ibid

> None of these is without difficulties.
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> 42. In practice, pension regulation and financial services regulation cannot be fully separated, not least because insurance companies play important roles both in pensions provision and in relation to financial services generally (as similarly do financial advisers). A single pensions regulator might be able to do more to ensure consistency of approach, regardless of the structure of the underlying scheme or product, but it is hard to see how such a regulator could also be the broader financial supervisor of providers which straddle the boundary between pensions and wider financial services. In practice, therefore, the first and third options come to much the same thing.
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> 43. A single financial services regulator could in principle avoid this problem, but would bring a different set of issues. Three in particular are:
>
> - the strongly held view, by representatives of employers in particular, that workplace pensions are distinct from financial services, not a subset of them: the underlying purpose which an employer has in sponsoring a pension scheme is quite different from the purpose a financial service provider has in selling products
> - the related concern that blurring the differences between funded pension schemes and other forms of investment management could lead to the creation of artificial and additional requirements for scheme solvency which would be a major burden on employers and schemes
> - the different nature of the customer relationship, where the choices made by both scheme members and employers as customers of provider companies do not map neatly onto the normal client role.[28]

It concluded that there was no structure that was clearly and unambiguously better than what we have now.[29] However, significant changes were in prospect with the implementation of auto enrolment, and the issue would need to be reviewed at a later date:

> 143. That fact strongly reinforces the conclusion that now is not the time for significant organisational change. There is a risk of any such change being an unhelpful distraction from the challenge of safe delivery of the current reforms. More importantly in this context, though, there is not yet sufficiently clarity about how provision will develop to be confident of making well-founded decisions. It would be rash and inefficient to make changes now which might well have to be reconsidered only a relatively short time later.
>
> 144. Equally though, it would be wrong to freeze the roles and structures of these bodies pending a future certainty and stability which may never come. Instead, the right balance is to expect that a more comprehensive review of the regulatory landscape is likely to take place during the next parliament. It should not be limited to the pensions-specific bodies, and should be designed to answer two questions:
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> - what are the risks for which regulation is the most effective mitigation?
> - given the answer to the first question, what regulatory structures will be most effective in delivering that mitigation?

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[28] DWP, *Triennial Review of Pensions Bodies. Stage 1: Options for delivery,* January 2014
[29] Ibid, para 45

> 145. That would provide the foundations for ensuring that the right legislative and regulatory structures are in place to support pensions provision for the next decade and beyond.[30]

In the Second Reading debate of the *Pension Schemes Bill 2014/15* on 2 September 2014, Pensions Minister, Steve Webb, said he had become more sympathetic to the view that the eventual destination might be a single regulator:

> It is fair to say that in drawing up the regulations and guidance for the Bill, the number of times we have had to ask ourselves which regulator it is that does which bit and to ensure that what the FCA does mirrors what the Pensions Regulator does has added to the complexity of the process. When I gave evidence to the Select Committee a little while ago, I said that this was not the time to start reforming the regulators. That remains my view. My hon. Friend will be aware that the FCA has only just been created out of the ashes of the Financial Services Authority. This precise point is not the right time for yet another regulatory reform. However, the experience of the last 12 months has made me more sympathetic to the view that the eventual destination might well be a single regulator.[31]

[30] Ibid
[31] HC Deb 2 September 2014 c202