

# Our Corporate Strategy 2008-2012

Next steps in risk-based regulation

October 2008

[www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk) 

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## Foreword

### **I am pleased to present the Pensions Regulator's Corporate Strategy for 2008–2012.**

As a risk-based regulator, the Pensions Regulator must give careful consideration to where and how we deploy our resources. In our first three years of operation we have developed our risk-based approach in relation to our objectives in the Pensions Act 2004, which are to protect pension scheme members, protect the Pension Protection Fund and promote good administration. We have made considerable progress, for example by putting in place the scheme specific funding regime which has improved the funding of defined benefit pension schemes, and by helping the regulated community to focus on the key risks to members of defined contribution schemes.

Since we published our *Medium term strategy* in 2006, the pensions landscape has changed. We have seen a continuation of trends such as the shift to defined contribution provision, as well as the emergence of new ones, such as the rapid growth in defined benefit scheme buy-outs. In addition, the Government has introduced the biggest pension reforms for a generation. These will create substantial change in many areas of pension provision. We are also very mindful of current economic conditions, which are by far the most challenging that we have seen in our short life as a regulator.

We continue to believe that risk-based regulation is the best way to regulate pensions and we will continue to take this approach, focusing on education and enablement, with enforcement as a last resort. But our focus and approach will evolve, to reflect the progress we have made and the changes we are seeing in pension arrangements we regulate.

**David Norgrove**

*Chair, the Pensions Regulator*

October 2008

## Executive summary

**Chapter 1** sets out the Pensions Regulator's role, beginning with its objectives which are set out in the Pensions Act 2004. These are to protect pension scheme members' benefits, protect the Pension Protection Fund and promote good administration. The Pensions Regulator ('the regulator') takes a risk-based approach to regulation, focusing on education and enablement, with enforcement as a last resort. Since its creation in 2005, substantial progress has been made, for example in setting up a scheme specific funding approach for defined benefit schemes.

**Chapter 2** presents a framework for identifying and monitoring risks which is increasingly being used to derive our priorities and measure the success of our work. These risks can be thought of as the factors which could lead a potential pension saver not to enjoy the pension income that they might reasonably expect. They include areas such as the level of contributions, investment and governance.

**Chapter 3** summarises the regulator's analysis of the pensions landscape. This analysis identifies key features and trends, including low financial capability, a shift in the nature of pension provision, the challenging economic climate and the substantial impact of the government's pension reforms.

**Chapter 4** uses the risk framework and analysis of the landscape to identify four key priority areas:

- preparing for the 2012 reforms and the new functions for the regulator as set out in the 2008 Pensions Bill, including achieving a new objective to maximise employer compliance with their new duties, regulating the Personal Accounts scheme and considering the wider impact of reform;
- key defined contribution (DC) risks including investment, charges and decumulation;
- key defined benefit (DB) risks of funding and market transitions such as buy-out; and
- administration and governance.

**Chapter 5** sets out at a high level our strategic response to these risk areas. This involves deepening the level of our understanding of key customers and stakeholders and working with them in the most effective way, including the use of new capabilities.

**Chapter 6** briefly sets out our next steps, noting that this document signals an evolution of the regulator's priorities and approach which will feed through into other documents and day-to-day work.

## **Chapter 1: Our role and achievements so far**

As the Pensions Regulator, we have been responsible for the regulation of work-based pensions schemes since we were appointed to that role by Parliament in 2005.

In 2006, we laid out our *Medium term strategy* that showed how we intended to carry out our duties. That strategy set out an approach up to 2009. Since then we believe a great deal has been achieved. We have also seen substantial changes in the pensions landscape, and the development of a major pension reform programme which will extend our role.

### **The purpose of this document**

Whilst we constantly monitor our approach to regulation and our focus, we believe that now is the right time to step back and consider our direction for the years ahead.

This document sets out our thinking. It explains our high level approach to pensions regulation and our current analysis of the pensions landscape. It then sets out the areas that we consider to be our future priorities and, at a high level, our approach to tackling these priorities.

This strategy represents an evolution of our role. We look forward to continuing to work with our customers and stakeholders as we implement this strategy.

### **Our role**

The Pensions Regulator is a risk-based regulator of work-based pensions.

Our objectives are, in summary, to protect the benefits of members of work-based pension schemes, to reduce risks to the Pension Protection Fund (PPF) and to promote good administration of work-based pension schemes. They are set out in full in figure 1.

Figure 1: The Pensions Regulator's statutory objectives  
The 2004 Pensions Act sets out our current objectives.

**Protect members' benefits**

Protect the benefits under occupational pension schemes of, or in respect of, members of such schemes, and protect the benefits under personal pension schemes of, or in respect of, members of such schemes.

**Protect PPF**

Reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund (PPF).

**Promote good administration**

Promote, and improve understanding of, the good administration of work-based pension schemes.

In addition, we expect the 2008 Pensions Bill, which is currently before Parliament, to give us a further role as part of the pension reforms which will come in from 2012. In summary, this role is expected to be as follows:

**Employer compliance**

Maximise employers' compliance with their responsibilities to automatically enrol their employees into a qualifying pension scheme, and pay matching contributions for those employees who do not opt out.

**Why we were created**

A series of governmental reviews and reports on pensions, over a number of years,<sup>1</sup> led to concern about the regulation of work-based pension schemes. A view gradually developed from this that a 'new kind of regulator' was needed – one that was more customer-focused and outcome-oriented, and one that was also transparent, proportionate and risk-based in its approach.

In 2005, as a result, the Pensions Regulator was established, and we took over the regulation of work-based pension schemes from the Occupational Pensions Regulatory Authority (Opra).

We derive many of our regulatory powers from the Pensions Act 2004 as a non-departmental government body which is accountable to the Secretary of State for Work and Pensions. We are funded by grant-in-aid from the Department for Work and Pensions (DWP), and our running costs are supported by the general levy on pension schemes.

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<sup>1</sup> See The Pickering Report 2002, the Quinquennial Review of the Occupational Pensions Regulatory Authority 2001 and the Green Paper: *Simplicity, security and choice: working and saving for retirement* 2003.

## Our approach

Three principles guide the way we regulate.

First, we are a risk-based regulator of workplace pensions. In practice this means that we focus our resources on priority areas. We do this by providing support and education to those involved in pensions decision-making, rather than being overly focused on enforcement activity. In summary, our approach is to educate and enable, and to enforce only as a last resort.

Secondly, we work as closely as possible with people from across the pensions landscape. Our regulatory policy emerges from real dialogue and consultation with the regulated community. This involves working not only with representative bodies but also, where appropriate, with individual market participants.

Finally, we always seek to develop evidence-based policy. For example, as well as our own research capability, we seek to harness the learning and analysis of others, whether in search of good practice or for further evidence of risk within the system.

## Priorities to date

In 2006, we published our *Medium term strategy*, where we laid out our priorities for the regulation of work-based pensions until 2009, based on our statutory objectives. It identified four strategic themes, which are mapped against our statutory objectives in figure 2.

Figure 2: Strategic priorities set out in our 2006 Medium term strategy

	Statutory objectives		
	Promote good administration	Protect members' benefits	Reduce risks to PPF
MTS core themes		Strengthen DB scheme funding	
		Improve governance	
		Reduce risks to DC scheme members	
		Deliver effective risk-based regulation	

## What we have achieved so far

Since the regulator was set up, a great deal has been achieved. We believe that these achievements show a good deal of success in becoming a genuinely risk-based organisation. Some examples of our achievements are shown in figure 3. More details about what we have achieved since our establishment in 2005 are provided in our *Annual report and accounts*, which are on our website: [www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk).

Figure 3: Some of our achievements so far

### **Educate and enable**

- Our free, interactive web-based training resource, the *Trustee toolkit*, has been widely welcomed by the industry and has received praise from users. At the beginning of October 2008 there were over 26,000 registered users of the toolkit. Our latest research found that 95% rated the toolkit as 'good' or 'very good'. Research, together with our latest *Governance survey*, has also shown a clear link between the use of the toolkit and improved standards of governance.
- We have continued to publish guidance to help trustees and advisers to understand their responsibilities and how to discharge them. We make all our codes and guidance available on our website, which receives an average of 80,000 visits per month. Our *Perceptions Tracker* research indicates that 92% of respondents are satisfied or very satisfied with our guidance.
- We ran a series of scheme funding workshops for practitioners to increase their understanding of the scheme funding regime. These proved to be very popular and highly rated by the many hundreds of trustees, advisers and others who attended.
- We seek to be as open and approachable as possible. We have received hundreds of clearance enquiries since we set up this process in 2005. Evidence suggests that in more straightforward cases and where applicants have previous experience, the system is becoming largely self-regulating.
- Through proactive contact with schemes we are able to help them handle scheme specific risks and ensure that they comply with regulatory duties efficiently and effectively (for example relating to recovery plans and scheme returns). We carry out over 500 outbound telephone calls a month as part of our ongoing proactive contact strategy.
- The impact of the triggers framework and scheme specific funding has improved protection for the PPF through shorter recovery plans and improved funding among pensions schemes.

### **Enforce**

- We are prepared to use our powers where appropriate.
- We have been involved in 52 independent trustee appointments and 456 member and third party appointments. Member and third party appointments are generally made to enable members to secure their own benefits, often due to ill health; to secure death benefits; or to allow a representative to act on behalf of a member based overseas.
- In the past year, we have issued our first Financial Support Directions.
- We have appointed independent trustees with exclusive voting rights to a pension scheme whose sponsoring employer was taken over.

- At any one time, we may be considering use of our powers in a number of cases; however, in most of these cases the potential use of our powers has proved sufficient to secure a satisfactory outcome.

We are - and will remain - a risk-based regulator. Our focus is on mitigating the most significant risks to member outcomes. With these achievements - and others - we have significantly increased the security of pension scheme members. However it is not possible, and we do not try, to remove all risk from the pensions system.

We have also received some positive feedback from our customers and stakeholders. In our annual customer satisfaction survey we are pleased to report that we are achieving very high levels of satisfaction overall (89%), and in the last year have experienced a significant improvement in the proportion stating they are very satisfied, rising from 50% in 2007 to 63% in 2008.

*Figure 4: Feedback on the Pensions Regulator*

In order to maximise our effectiveness it is important for us to understand how our approach is being perceived across the regulated community. To this end we carry out regular research among our external customers and stakeholders.

Over the past year the results have shown that we continue to be seen as:

- a trusted source of information;
- focused on the most important risks to members' benefits; and
- proactive in reducing risks

Encouragingly, over three-quarters of those questioned in our *Perceptions Tracker* survey felt that if we did not exist, the risk to members' benefits would increase.

Our key stakeholders have reported that they have continued to be impressed with our progress. In particular, they highlight our continuing work on clearance, the *Trustee toolkit* and our secondee programme as evidence of our credibility and professionalism.

In October 2007, the National Audit Office published a positive report on the regulator noting that '...TPR (the Pensions Regulator) has made good progress in establishing a risk-based approach to regulation. It has focused on those areas that currently present the greatest systematic risks to pension scheme members and the PPF... 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.' (Source: *The Pensions Regulator: Progress in establishing its new regulatory approach*, NAO, October 2007.)

Following this report the Public Accounts Committee of the House of Commons held an evidence session and published its own report on the regulator, concluding that 'The Pensions Regulator, set up following a very critical report by this Committee on its predecessor Opra, is doing a much better job at regulating the pensions industry.'

Unlike the unlamented Opra, the Pensions Regulator actually has processes in place for identifying the greatest risks to members' benefits.' (Source: *Public Accounts Committee press notice, 24 April 2008.*)

### **Engaging across the pensions landscape**

As a small regulator of a large pensions landscape, engaging with our customers and other stakeholders is crucial to our regulatory approach. To illustrate, in our first three years of operation:

- we have received over 2.7 million visits to our website;
- over 26,000 people have registered for the *Trustee toolkit*, our online education tool;
- we have received over 112,000 calls into our customer support team;
- we have issued over 120 press notices covering matters such as issuing guidance, publicising our action and making statements; and
- regulatory staff have spoken at several hundred industry events.

In addition, we hold regular discussions with key organisations and groups from across the pensions landscape. We are proud of the numerous good relationships that we have helped to build with trustees, advisers, employers, unions, representative bodies and many others.

Since 2005 we have held a significant number of formal consultations, as well as many less formal consultation exercises, and have received many hundreds of responses to these consultations. We are very grateful to all those who have engaged with us and strongly believe that this input has improved the way in which we do our job.

As well as working with the community we regulate, we have a number of important relationships with others involved in regulation and legislation. We work particularly closely with DWP, our sponsoring government department. We also work closely with the PPF, our sister organisation, and the Financial Services Authority (FSA), who also have a key role in pensions regulation, as well as with bodies such as HM Revenue and Customs (HMRC), the Pensions Ombudsman, The Pensions Advisory Service (TPAS) and HM Treasury.

We also have a formal role as part of the EU framework for regulation. We are a member of the EU Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) as the UK's regulator of pensions. Our Chief executive Tony Hobman is Chair of the Occupational Pensions Committee, which sits under CEIOPS and drives forward work on the operation of the EU pensions directive under which UK pensions law operates. In addition we are a leading member of the International Organisation of Pension Supervisors (IOPS) and the OECD, which brings together the expertise and best practice in pensions regulation of over 60 international regulators. The progress we have made as a risk-based regulator has featured strongly as a model for other regulators starting along the same path.

## Chapter 2: Our strategic framework

We take a risk-based approach to regulation for a number of reasons:

This is part of the remit we were given by Parliament, following concern that our predecessor body, Opra, was not as effective as it should have been.

This is the approach commonly recognised as ‘good regulation’, for example by the Hampton Review and the Better Regulation Executive. Figure 5 sets out their principles of good regulation in more detail.

This is a pragmatic approach to being a small regulator of an extensive pensions landscape. Alternative approaches would, we believe, be less effective or more expensive.

*Figure 5: Principles of good regulation*

In 2004, the then Chancellor asked Philip Hampton to consider the scope for reducing administrative burdens by promoting more efficient approaches to regulatory inspection and enforcement. The final report of the Hampton Review, *Reducing administrative burdens: effective inspection and enforcement*, was published in March 2005 and made the following recommendations:

- comprehensive risk assessment should be the foundation of all regulators’ enforcement programmes;
- there should be no inspections without a reason, and data requirements for less risky businesses should be lower than for riskier businesses;
- resources released from unnecessary inspections should be redirected towards advice to improve compliance;
- there should be fewer, simpler forms; and
- data requirements, including the design of forms, should be co-ordinated across regulators.

In addition, the Better Regulation Executive identified five key principles of good regulation. These state that any regulation should be:

- transparent;
- accountable;
- proportionate;
- consistent; and
- targeted (directed at cases where action is needed).

The Pensions Regulator has regard to these principles in devising its strategic approach and in its day-to-day regulatory activities.

Through our *Perceptions Tracker* survey we measure the extent to which many of our customers and stakeholders believe that we operate in line with the Hampton Principles. We are pleased that this research shows that we have made good progress, achieving significant increases over the last year in terms of being perceived as proportionate (51% agree) and consistent (57% agree) as well as a trusted source of information (84% agree) and with very low percentages disagreeing with any of these statements. We acknowledge, however, that we have further to go in demonstrating transparency within the constraints placed on us by legislation and the need to maintain commercial confidentiality.

### **How we identify risk**

At the heart of our risk-based approach is the need to identify key risks so that we can focus our effort and resources on them. To do this, we use a high level framework which identifies possible areas of risk. We then use our analysis and research-based understanding of the pensions landscape to assess these risks and to determine priorities.

The high level risk framework that the regulator uses to identify potential risk areas is set out below. It is deliberately high level and is designed as far as possible to be applicable to the main types of pension provision: DB, DC, trust-based and contract-based. Although these risks relate to all four of our current and future statutory objectives, the framework might be thought of as identifying the factors that could create risks for a potential pension saver in realising the income in retirement that they might reasonably expect. The risks are listed roughly in the order of a person's lifecycle of pension savings. The framework is also used by the Pensions Regulator to help to clarify what is solely within our regulatory ambit and where we need to work closely with others, such as the FSA.

The areas identified are those of potential risk; these are areas which the regulator could consider to be priorities at some point. They are not all areas of significant risk now. The examples given are for illustration only, and are not complete descriptions of the potential risk areas.

Figure 6: Our high level risk framework

		DB	DC	Contract-based	All
Risk area	Examples	Who bears risk?	Who bears risk?	Who bears risk?	Who regulates?
<b>Join</b>	Employee not offered good scheme,	Member	Member	Member	From 2012, TPR.
<b>Contribute</b>	Employees don't contribute enough.	Employer/PPF*	Member	Member	From 2012, limited role for TPR to pursue statutory minimum.
<b>Funding</b> <sup>2</sup>	Employers don't contribute enough.	Employer/PPF*	N/a	N/a	TPR
<b>Investment</b>	Wrong investment choices result in poor return / underfunding.	Employer/PPF*	Member	Member	TPR & FSA
<b>Administration</b>	Scheme data poorly managed	Employer/PPF*	Employer / third party administrator	Member / Provider	TPR
<b>Governance</b>	Poor decisions not in members interests.	Employer/PPF*	Member	Member	TPR, Trust Law where applicable
<b>Charges</b>	High charges erode scheme/members' assets.	Employer/PPF*	Employer / Member	Member	TPR has a role
<b>Decumulation</b>	Member makes wrong annuity choice.	Employer/PPF*	Member	Member	TPR. <sup>2</sup> and FSA
<b>Transitions &amp; Mkt Dev</b>	Uninsured buy out. <sup>2</sup> Provider switch.	Member, FSA	Employer / Member	Member	TPR & FSA
<b>Member Understanding</b> <sup>3</sup>	Poor decisions to join, contribute, invest, decumulate	Member, FSA	Member	Member	Mix of TPR, FSA, (DWP, HMT)

<sup>1</sup> ie.GPPs, Group Stakeholders, Group SPPs. <sup>2</sup> DB funds only \* PPF limits mean some members bear risk.

<sup>3</sup> Lack of member understanding is not so much a risk as a factor that affects the probability & impact of other risks

## Our risk analysis

Once we have identified where we might find risks to the achievement of our objectives, we use a detailed understanding of the pensions landscape, based on analysis, research and engagement with others to consider these risks.

To identify priorities, the risks are assessed against two criteria:

- the likelihood of a risk materialising; and
- the impact if the risk were to materialise.

## Chapter 3: Our analysis of the pensions landscape

The regulator takes the view that it is for individuals to make the right choices for themselves when it comes to pension savings. We believe it is also for employers to determine their approach to providing pensions to their employees, as long as they comply with the law. We do not therefore express a preference between DB and DC provision, between trust-based and contract-based provision, about the level of contributions members should make, or about the pros and cons of the Personal Accounts scheme. Instead, we believe it is our job to regulate the pensions landscape as we find it and to ensure that high standards and good practice are observed by those who run, sponsor and advise pension schemes.

Much has been written about the nature of the UK pensions landscape, and we do not attempt a full exposition here. Instead we seek to draw out briefly some of the key features and trends which we have considered in assessing our priorities.

### Wider environment

Financial capability is generally low, as demonstrated by a number of sources, including the FSA's financial capability baseline survey. This may mean that people do not make the right decisions for themselves, for example when it comes to choosing to save, deciding how much to contribute or picking investment options.

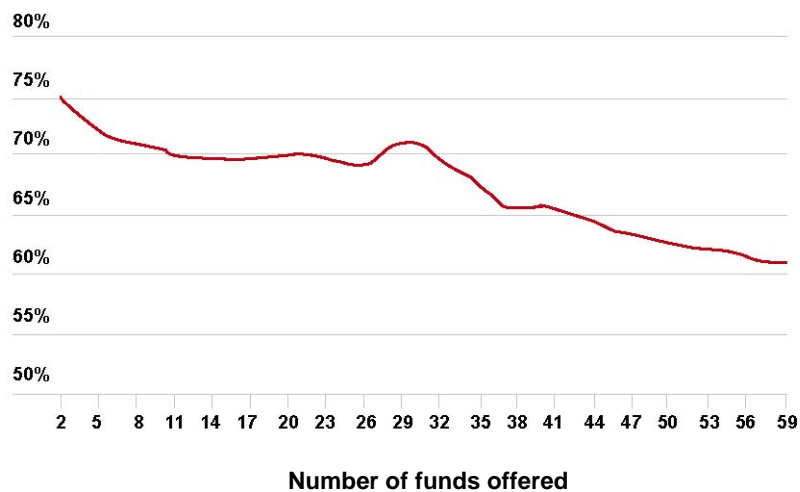
Figure 7: Financial capability

Number of weak areas	Cluster	Per cent of sample	Weighted base	Description (typical examples)
0	Ai	36	1929	Very capable, well-off, older couples, many financial products.
1	Bi	13	692	Older, lower income, good at money management generally, fairly capable given their circumstances.
	Bii	9	455	Not organised, middle-aged couples.
2	Ci	4	218	High-income, younger couples, living beyond their means.
	Cii	4	209	Young, well-organised, middle incomes, 'living for the day'.
3	Di	3	151	Older, lower income, less good at keeping track of money.
	Dii	3	163	Middle aged, very low-income group, reasonable at making ends meet, fairly capable given their circumstances.
	Diii	7	373	Young singles with some financial engagement.
4	Ei	16	854	Low-income, younger, single people, few products.
	Eii	2	108	Early middle-aged, few products, some planning.
5	Fi	3	175	Younger, with children, struggling on low incomes, disorganised.
<i>Total</i>		<i>100</i>	<i>5328</i>	

Source: FSA financial capability baseline report

A range of evidence which may loosely be termed 'behavioural economics' suggests that even when people do fully understand the decisions they need to make, they do not always take the decision that is best for them. A growing literature suggests, for example, that inertia is powerful, that the 'framing' of decisions affects outcomes, that people procrastinate and that too much choice can put people off. Figure 8 illustrates this last point, showing that more investment choice is associated with lower participation rates in pensions.

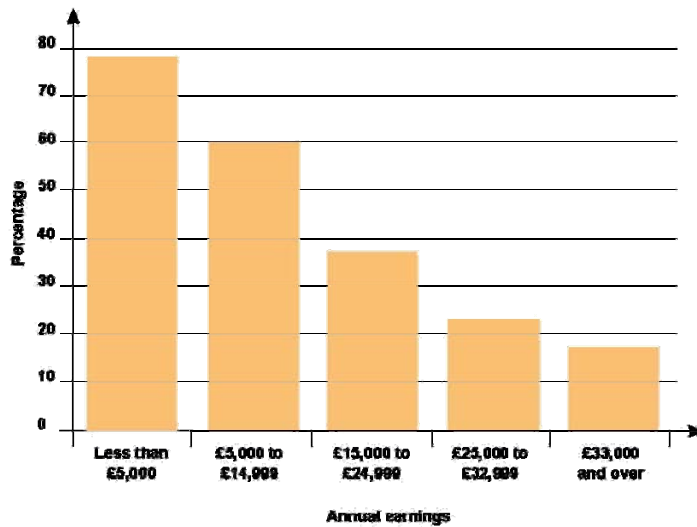
Figure 8: Participation rate in US company pension plans as fund choice increases



Source: *Iyengar, 2003*

Partly as a result of some of these features, many people do not save in pensions at all. This may be appropriate in some cases, but for most people it is something that they may later regret.

Figure 9: Employees not contributing to a private pension, by earnings band



Source: Family Resources Survey 2004/05, UK

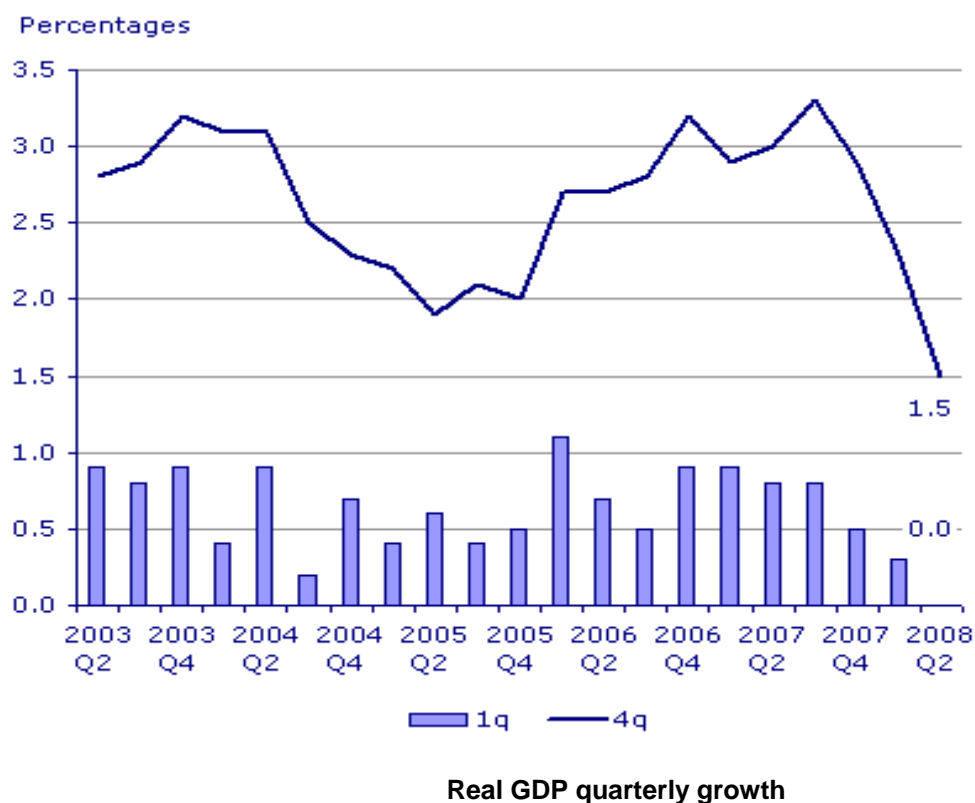
We will continue to work with key partners on the evolving landscape and ensuring our approach is fit for purpose.

### **More challenging macro-economic environment**

We are now experiencing the most challenging financial and economic environment in the regulator's short life. This has a number of significant implications for pensions. For example the value of some assets has declined and we have seen increases in asset price volatility.

In addition, increasing prices and declining economic growth mean that many businesses and consumers find themselves in tighter economic circumstances. We are very mindful of the challenges this creates for many of our customers and stakeholders.

Figure 10: UK real GDP growth change on previous quarter and on year earlier



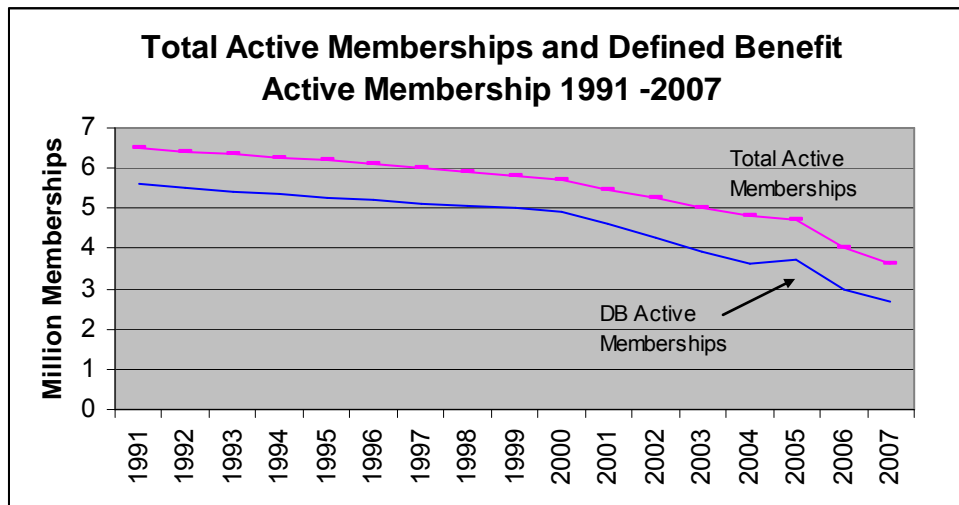
Source: Office for National Statistics (ONS)

Pensions are a long-term matter, and we believe that these challenges should be seen in the context of a longer term which has seen periods of better and worse conditions. The regulator is sensitive to the wider climate, but we believe that the regulatory framework of which we are part will prove to be robust to these conditions for the foreseeable future.

**Changing mix of provision**

There are two key long-term shifts in the nature of pension provision. The first is the well documented decline in private sector DB provision which has been going on for several decades, as shown in figure 11. Between 1991 and 2007, DB active memberships fell from 5.6m to 2.7m. DC trust-based memberships are now around 1m, though have been stable in recent years, with contract-based DC (known as Group Personal Pension Plans) estimated by the Association of British Insurers (ABI) to now number some 3m memberships.

Figure 11: DB and trust-based DC active membership



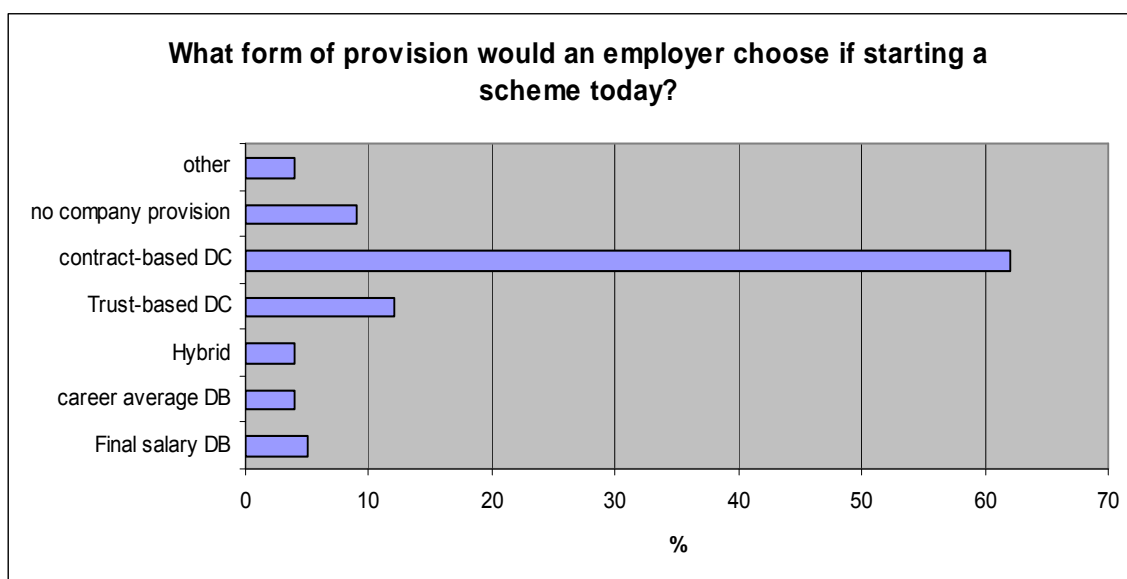
Source: ONS OPSS 2007

(Note that data points between ONS survey data have been interpolated to aid visibility of the time series. In 2000 there were classification changes to the public and private sector.)

On average, DB pensions have higher contribution rates than DC (particularly with respect to employer contributions). This is not an inherent feature of the different types of provision, but is something that has been observed, and the shift from DB to DC provision has often been associated with a reduction in pension contribution rates.

In addition, we have more recently seen a shift within DC provision from trust-based to contract-based provision. Figure 12 illustrates that employers are much more likely to want to set up contract-based pensions.

Figure 12: Forms of provision that employers would choose if starting a scheme now



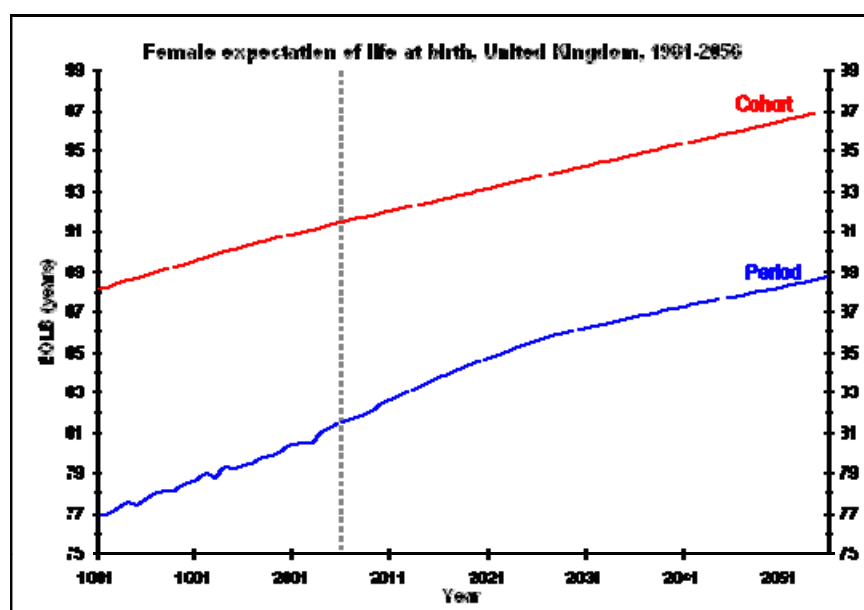
Source: Fidelity International, Viewpoint, January 2007

These trends mean that someone joining or actively contributing to a pension scheme is now more likely than in the past to be in a DC rather than a DB scheme, and a contract-based rather than a trust-based scheme. This change has significant implications for the nature of the risks in pension saving and who bears these risks. However, from a regulatory perspective, it is also important not to overstate their impact. It remains the case that trust-based DB provision dominates the stock of occupational pension assets and members. The lifecycle of pension savings is such that if the decline of DB provision continues, as many expect, then it will take several decades for the effects to fully work through. For the foreseeable future, DB provision remains a substantial part of the landscape.

### DB challenges

There is a long-term increase in the challenges associated with DB provision, related to its declining popularity. Costs have been increasing, for example because of improved longevity and scheme maturity, and businesses and investors are more conscious of these costs, for example because of developments in accounting standards.

Figure 13: Recent improvements in female longevity



Source: GAD

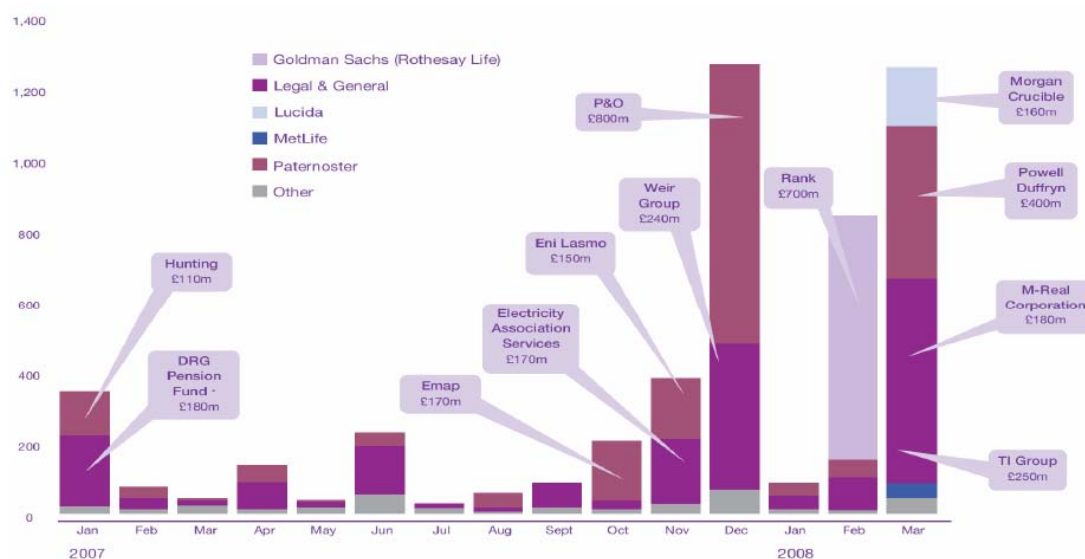
A more recent trend in DB provision is the emergence of innovative solutions to the management of pension scheme assets and liabilities. The last two to three years have seen significant growth in transactions which shift some or all of the risks in DB pension schemes to counterparties such as insurance companies. These transactions can be of several forms, for example:

- 'buy-out', where an insurance company takes on all the assets and liabilities of a DB scheme;
- 'buy-in', where a scheme buys assets to directly hedge an element of their liability risk; and
- transfers, where individual members opt to transfer their DB pension rights into a DC scheme.

As shown in figure 14, buy-out solutions have shown a particularly dramatic growth recently, and we have also seen the emergence of blended solutions which use more than one approach to manage liabilities. Although we have seen substantial growth in these new ways to manage pensions, the size of the market is still small compared to the total stock of DB liabilities. The regulator will be vigilant to ensure the risks to members' benefits are not adversely impacted by such transactions.

Figure 14: Growth in buy-out activity

**The following chart shows when and where what business was placed**



Based on data supplied by insurance companies. Buyout dates are defined as when contract documentation is signed, or when assets are transferred.  
\* Note: DRG Pension Fund was written partly over December 2008 and January 2007. For the purposes of this chart we have shown it as all occurring in January 2007.

Source: Lane, Clark, Peacock

## Pension reform

Following the Pensions Commission's recommendations, the Government is in the process of introducing changes to UK pensions. These changes will:

- make state pensions fairer and more generous, but available at a gradually increasing age;
- require employers to automatically enrol many of their staff in a qualifying pension scheme and make matching contributions on behalf of those staff who do not choose to opt out; and
- set up a large new multi-employer occupational DC pension scheme, known as Personal Accounts.

As part of these changes, the Bill that is currently before Parliament is expected to give the Pensions Regulator a new role and accompanying statutory objective. It will be our job to maximise employers' compliance with their new duties. This represents a substantial challenge for the regulator, and this is discussed below.

The changes are expected to have a very substantial impact on the UK pensions landscape. The introduction of automatic enrolment is expected to increase the number of people saving in private pensions by perhaps 8m once these changes are introduced from 2012. It is expected that the increase in the number of savers and the matching of contributions will lead to an increase in overall pension contributions of perhaps £8bn per year (source: DWP).

There are a number of substantial uncertainties associated with these changes which mean that the shape of the future pensions landscape is not yet clear.

- The level of opt out, and therefore of participation, amongst eligible employees cannot be precisely predicted. This means that the total number of people who will be saving in pensions is uncertain.
- Employers will need to choose a qualifying scheme in which to enrol their staff. They will have a choice over the type of qualifying scheme to use (DB, trust-based DC including Personal Accounts, contract-based DC or a mix) and we do not yet know the outcome of their choices. This means that the mix of pension provision that we will see is not yet known.
- The increase in pension participation and saving levels, and the change in joining mechanism, may change the commercial attractiveness of related markets. It is too early to know how commercial providers and others in these markets may respond. We cannot yet know the impact of these responses on the pensions landscape.

Whilst the precise impact of these changes is uncertain, it is clear that the effect of the changes we will see is likely to be large, compared even to the substantial extent of private pension provision in the UK today.

- The Personal Accounts pension scheme is expected to be the largest pension scheme, by far, in the UK. It is expected to have perhaps 5m members and hundreds of thousands of sponsoring employers. It is expected to receive annual contributions of £5bn per year, building to assets under management of perhaps £100bn.
- It is likely that much of the increase in pension saving will be DC in nature. This means that some of the risks in DC pension provision, for example around investment choice, could become more significant. This increase in risk is heightened by an expectation that a substantial proportion of new pension savers will not have high levels of financial capability.

## Chapter 4: Our priorities

Drawing on our understanding of the UK pensions landscape, which is summarised above, we seek constantly to assess the probability and impact of the potential risks to our objectives.

To do this, we seek to look at the pensions landscape through the ‘lens’ of the risk framework presented in chapter 2. This analysis necessarily involves an element of subjectivity and judgement but is an important step along the way to identifying our strategic priorities.

Figure 15 sets out at a high level our current assessment of the probability and impact of different risks. It should be noted that this diagram attempts to assess the probability and impact of risks to the regulator’s objectives. Assessing these risks for a different purpose could clearly lead to different results.

Figure 15: High level risk assessment



Risk area	DB (Larger segment)	DC Trust-based	GPP
Auto enrolment	High / Low	High / Low	High / Med
Contribution rate*	High / Low	High / Low	High / Med
Funding	High / Medium		
Investment	Low / Med	High / High	High / High
Administration	Med / Med	Med / Med	Med / Med
Governance	Med / Low	High / Med	High / Med
Unreasonably high charges**	Low / Low	High / Low	High / Med
Decumulation	Low / Low	Med / High	Med / High
Transition/Market Developments	Low / High	Med / Med	Med / Med
* From 2012 ** more significant role for the Pensions Regulator from 2012			

Poor member understanding is not included in the diagram above. This is because we consider it to be a factor that increases the probability and impact of other risks. It is therefore a contributing factor to the ratings in the diagram, rather than a risk in itself for these purposes.

### Four priority areas

The above analysis indicates four priority areas for the regulator. In our risk-based approach to regulation, these are the areas in which we plan to focus our effort and resources.

## Preparing for 2012

There are three particular areas on which we are focused:

- In order to fulfil the extended remit that we expect Parliament to give us in the current pensions Bill, the regulator needs to build the capability to ensure maximum employer compliance with their new duties. We have begun some of the early preparation of this work. At a high level we intend to take an approach to this activity that is similar to that of our current regulation: we plan to be risk-based and to focus on educating and enabling, with enforcement as a last resort.
- The Personal Accounts pension scheme, which will be delivered by the Personal Accounts Delivery Authority (PADA), will be a multi-employer trust-based defined contribution pension scheme. It will fall within our regulatory ambit and we intend to regulate it much as we would any other scheme. However, because it will be very large we expect that we will need to pay particular attention to its regulation.
- As noted in our analysis of the pensions landscape, the 2012 reforms are expected to have a major impact across the pensions landscape. This will involve a combination of those members that join the Personal Accounts scheme, as well as those enrolled for the first time in existing employer provision, or for whom contributions will increase. The extension of automatic enrolment as a joining mechanism is likely to mean that many people save in pensions without having made an active choice to do so. Since much of the additional saving we expect to see is likely to be DC in nature, this is likely to increase the importance of DC risks to members. An issue of particular importance will be the default investment option, which qualifying DC schemes will need to provide.

### **Key DC risks**

Recent trends in pension provision, outlined above, mean that DC provision is becoming increasingly important. It is the case that more risks are borne directly by members in DC, and the regulator has previously identified five key risks in this type of provision. These remain a priority area and will receive increased focus. They are:

- Investment, where we will not get involved in prescribing asset allocations, but are keen to help make sure members are offered suitable options and defaults, and are provided with information to help them make appropriate choices.
- Charges, where we intend to keep under review the evidence base on the level of charges borne by members in different types of provision, and to promote transparency.
- Decumulation, where we will continue to work with others such as the FSA and TPAS to help ensure members make the right choice of product and take advantage of the options available to them.
- Member communications, where we will continue to focus on helping trustees and others to communicate to members as effectively as possible. The regulator believes that poor financial capability is an important issue for pensions, and we will continue to actively support the FSA, which leads the National Strategy for Financial Capability.
- Administration, which is discussed below.

### **Key DB risks**

DB has been the main focus of much of our regulatory activity since we were set up, and we believe we have made substantial progress. Whilst other risk areas are becoming increasingly important, DB remains a priority area in two respects:

Funding, where we remain committed to risk-based regulation of DB scheme funding. We believe that the approach we operate has demonstrated considerable success to date in boosting funding and that it is also increasingly well understood by the regulated community. We therefore plan to continue to apply it in its current form, whilst keeping under review the details of its approach, and its performance in more challenging economic conditions.

Market transitions, where we are generally supportive of the development of solutions such as 'buy-out' and 'buy-in' but have been concerned about the possibility of a narrow subset of activity. The current pensions Bill includes proposals for an extension of our powers to intervene in this market in certain circumstances. We intend to maintain our regulatory approach of 'educate, enable, and enforce as a last resort' and therefore expect to use these new powers very rarely.

### **Governance and administration**

These issues remain important to the regulator and, in a sense, cut across and support all three of the priority areas identified above. Good governance is crucial in managing many of the risks associated with DC and DB and will also be important in relation to the Personal Accounts scheme. Automatic enrolment increases the importance of this work significantly. We will continue to take a close interest in promoting good governance, including in the seven areas that we have identified as important:

- knowledge and understanding;
- conflicts of interest;
- the employer covenant;
- relations with advisers;
- administration;
- processes for investment choice; and
- governance during wind-up.

Two particular areas of continuing focus include record-keeping and wind-ups.

## **Chapter 5: Our regulatory response**

This chapter outlines our approach to tackling the priority risks that have been identified. This discussion is intentionally high level, focusing on approach, rather than a detailed plan of outputs and work areas. This more detailed breakdown is regularly presented in the Pensions Regulator's annual business and corporate plans and then is reviewed each year in our annual reports. These documents can be found on our website, [www.thepensionsregulator.gov.uk](http://www.thepensionsregulator.gov.uk).

At a very high level, our approach to reducing the probability and impact of these areas of risk has three steps: to identify whom we need to work with, to understand how best to engage with them, and to choose the most effective regulatory interventions.

### **Identifying whom to work with**

As a risk-based regulator, our focus is on education and enablement, with enforcement as a last resort. Clearly the effectiveness of all three of these types of regulatory intervention depends on our working with the right people.

In each priority area our approach is therefore to identify the decision makers who directly affect the probability and impact of the risk. We are also keen to identify those people who influence these decision makers.

Although the people we need to work with vary across the different risk areas, at a high level we have identified our key customer and stakeholder groups. These include pension scheme trustees, sponsoring employers, advisers, commercial providers, unions, the collective bodies of many of these groups, other regulatory bodies and the media, amongst others.

### **Understanding our customers**

We are using a number of approaches to refine our customer insight so that we can engage with our customers as effectively as possible and make the best use of finite resources. For example:

- Our annual perceptions tracker survey, which asks many of our customers and stakeholders what they think of us. Its results can be found on our website.
- Our annual governance survey, which asks pension scheme trustees about how they do their jobs. Its results are also on our website.
- Engaging with stakeholders through structured telephone discussions, conferences and other events. There is a request form on our website for stakeholders who would like us to take part in an event.
- Knowledge management, where we have been developing our ability to learn in a more tailored way from the cases we are involved in.

Going forward we are also developing our capability. For example:

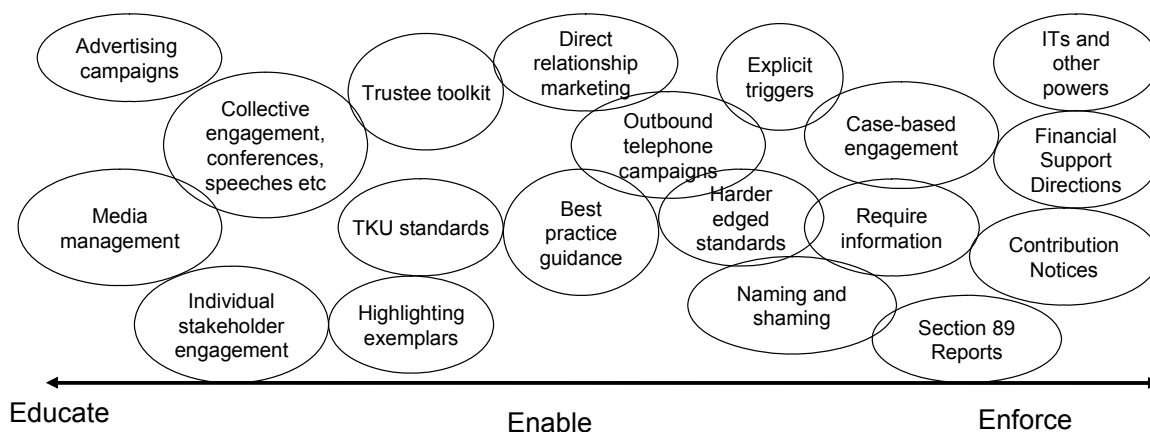
- We are reviewing our *Trustee toolkit*, along with the code of practice and scope guidance, to make sure they are up to date.
- Outbound call capability, where we are enhancing our ability to get in touch with trustees and others through structured telephone campaigns.
- We are developing our capability to harness new media and communications techniques to better reach some audiences, such as the large number of small schemes, in a more tailored and focused way.
- We are also taking new approaches to guidance to make it more accessible to wider audiences and easier for quick reference.

### Choosing our regulatory interventions

Having identified whom to engage with, we are in a position to select the best interventions from those at our disposal. We think of these options in a broad sense, ranging from engaging through the media to harder-edged interventions such as issuing contribution notices, as shown in figure 16.

Our approach to regulation is to educate and enable, and to enforce only as a last resort. Many of our interventions are in the area of education and enablement, and are in the left and centre of the diagram. We only use our powers of enforcement, towards the right of the diagram, rarely and when we believe it is necessary.

Figure 16: Illustrative range of our regulatory interventions



We are conscious that many of our customers and stakeholders engage with us repeatedly over time. So these interventions are not one-offs, and will often be complemented by others.

## **Operational efficiency**

We believe that the Pensions Regulator is already an efficient and effective organisation. But going forward we will continue to seek efficiencies in all areas of our work.

In order to maintain our performance as an effective regulator offering value for money, it is essential that we have the capability to learn, improve and adapt. Over the coming years we will aim to achieve continuous performance improvements in our operational effectiveness, efficiency, quality and customer service. Being an adaptive and flexible organisation enables us to reduce the regulatory burden on those we regulate and work with, and is also consistent with our risk-based regulatory approach.

We will achieve this by, for example:

- Continuing to automate our processes wherever possible to improve efficiency and reduce the administrative burden to schemes. We have undertaken a review of our scheme return and levy services which have resulted in significant improvements to our scheme return handling capabilities. We have successfully launched a new user-friendly web-based application for scheme returns. Further planned enhancements will eliminate the need for paper forms and offer easier ways to process payments, such as by direct debit and credit card.
- Continuing to introduce more innovative ways of data management and analysis to ensure that we have the best possible information. This will involve working closely with the PPF to produce the *Purple Book* annually. Additionally, we will continue to develop the means to collect and publish DC data.
- Continuing to build our campaign capacity, and increasing the flow of targeted messages and communication to key audience segments, for example smaller schemes.

## **Chapter 6: Next steps**

The Pensions Regulator will continue to be a risk-based regulator. We will also continue to focus on education and enablement, with enforcement as a last resort. But there will be an evolution of our focus, to reflect both the progress we have made since we were set up following the 2004 Pensions Act and the changes we are seeing in the landscape we regulate.

Our remit will expand as we take on a new objective to maximise employers' compliance with their new duties following the current pensions Bill. And whilst we will continue to focus on key risks in DB schemes, our focus will increasingly be on the implications of the current pension reforms and DC pension provision. We will also continue to maintain a strong focus on the good governance and administration of schemes overall.

As well as an evolution of our priorities, this document also signals an evolution of our approach. We will need to work with a wider range of customers and stakeholders, for example by increasing our focus on the large number of small pension schemes and by engaging with employers who do not currently offer a pension scheme to their staff.

The strategic approach set out in this document will cascade through our business and corporate plans and annual reports. We will publish the next set of these documents on our website around the start of the 2009–2010 financial year.

This document is not part of a formal consultation exercise. However, we are very grateful to the many people who have given their input as we have been refreshing our strategy. We would also welcome comments and feedback.

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