

THE OCCUPATIONAL PENSION SCHEMES (INTERNAL CONTROLS) REGULATIONS 2005

GOVERNMENT'S RESPONSE TO CONSULTATION

Introduction

1. In July 2005, the Department undertook a consultation on the requirement that occupational pension schemes should have adequate internal control mechanisms. The consultation ended on 9 September 2005.

2. Nine responses to the consultation were received. A list of respondents is attached at **Annex A**. The Department is very grateful to all who contributed to the consultation.

3. The Occupational Pension Schemes (Internal Controls) Regulations 2005 (S.I. 2005/3379) were laid on 9 December 2005 and come into effect on 30 December 2005.

4. The regulations are available on OPSI's website at:

<http://www.opsi.gov.uk/stat.htm>

5. This document is available on the Department's website at:

<http://www.dwp.gov.uk/consultations/2005/>

6. A paper copy of this document can be obtained from:

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Disclaimer

7. This document describes the policy underpinning the Occupational Pension Schemes (Internal Controls) Regulations 2005. The commentary on the regulations should not be taken as an authoritative statement of the law. Such an interpretation can only be provided by a court.

Response to Consultation

Introduction

1. The regulations implement the requirements in Article 14(1) of the Directive¹ that occupational pension schemes should have adequate internal control mechanisms. The key policy issues raised in the consultation are considered below.

Proportionate

2. Concern was expressed by a number of respondents as to whether the draft regulations were taking a proportionate approach to the implementation of the Directive. Respondents were concerned that the draft regulations looked like an absolute requirement and did not include the necessary measures of proportionality and flexibility that were necessary accompaniments in the implementation of EU Directives.

3. The regulations require trustees and managers to establish and maintain adequate internal controls. In addressing this requirement the Government would expect trustees or managers to undertake a risk assessment; for each area of risk identified, an adequate internal control should be put in place.

4. The Government recognises the concern that this is a “one size fits all” approach. However the Government does not consider that this will be the case. In practice decisions made by trustees or managers about their internal controls will be determined by the nature of their scheme and by the risks they are addressing. And in coming to a view about the type of internal controls needed, they will be able to take cost into account in considering how those risks should be addressed.

5. The Pensions Regulator has agreed to issue a Code of Practice on the requirement for internal controls. The Code will provide practical and pragmatic guidance on how this requirement can be met.

6. In the Government’s view, its policy is addressed by the regulations as consulted on, and so no changes have been made to the regulations.

Delegation

7. One respondent wanted clarification of the position where the trustees or managers delegated responsibilities to third parties, for example the responsibility for the custody of assets. Trustees or managers could not be expected to establish and operate internal controls in respect of functions delegated to third parties.

8. The Government’s view is that the trustees or managers continue to have responsibility for the safe running of their scheme, notwithstanding that certain activities have been delegated to third parties. Clearly it would not be appropriate for trustees or managers to be responsible for the establishment and operation of the third party’s internal controls. However the arrangements that trustees or managers have

¹ Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision. Article 14(1) requires that “The competent authorities shall require every institution located in their territories to have sound administrative and accounting procedures and adequate internal control mechanisms.”

with third parties must be sufficient so that they can discharge their responsibilities.

9. The regulations have been reviewed by the Government's legal advisers who are content they meet the policy requirement.

Sanctions

10. There is no direct sanction for breaching the requirement on internal controls. It is expected that breaches of other requirements will highlight any inadequacies in the internal controls mechanisms and it is these other breaches that will be the primary subject of any sanctions. However the Regulator does have a range of general sanctions at its disposal including the power to issue improvement notices and third party notices which can be deployed in cases where the Regulator is concerned about the adequacy of a scheme's internal control mechanisms.

11. One respondent however expressed concern that the lack of a specific sanction might leave the trustees or managers open to claims for compensation for any losses arising out of the inadequacy of the internal controls mechanisms. Notwithstanding whether or not a breach is sanctionable, it will always be open to members to take action against the trustees or managers if they have grounds for doing so.

“Public service schemes”

12. The draft regulations exempt public service schemes from the internal controls requirement. However in the consultation the point was made that public service schemes needed internal controls as much as private sector schemes. Article 5 of the Directive allows the Government to exempt statutory schemes that are guaranteed by a public authority. The Government has already taken the view that public service schemes should be exempted from other scheme administration requirements because there are already extensive checks and controls on the use of public monies which provide equivalent safeguards. The Government considers that this also applies in relation to internal controls.

Code of Practice

13. Several respondents said that they found it difficult to comment on the draft regulations without sight of the Code of Practice, to be produced by the Pensions Regulator. The Government accepts that it would have been better to have consulted simultaneously on the draft regulations and the Code of Practice. However the Government's obligations under the Directive mean that regulations have to be put in place as soon as possible. This has, as a result, led to the fast tracking of the regulations ahead of the Code of Practice.

14. Having said that, the Government accepts that this is an important issue and that there is need for joined-up working. As a first step, the Regulator has agreed to make available to the Government any relevant responses to its consultation on the Code of Practice, subject to any request for confidentiality. The Government will consider whether any of the issues raised in relation to the draft Code read across to the draft regulations. Thereafter, the Government will work closely with the Pensions Regulator to make sure that the Code of Practice is published in its final form as soon as possible.

TECHNICAL ISSUES

15. A number of technical amendments have been made to the regulations. The main changes are as follows.

New section 249A(1)

16. The phrase “for the purpose of securing that” has been added to enhance the clarity of the requirement. The policy is not changed.

New section 249A(3)

17. This subsection describes the schemes that are exempt from the internal controls requirement. The exemptions are provided for in the Directive by Article 2(c) (pay as you go schemes) and Article 5 (statutory schemes backed by a public authority guarantee). The definitions of the exemptions have been revised to more accurately capture the types of scheme being exempted.

18. The Parliamentary Contributory Pension Fund falls within Article 5; however rather than trying to capture it within the generic definition it was agreed the best approach would be to individually exempt the scheme. The regulations therefore refer to the legislation establishing the scheme.

New section 249A(5)

19. The definitions contained in this subsection have been revised to reflect the changes made in the earlier part of the section.

Consultation responses

The Actuarial Profession
Association of British Insurers
AXA
Electricity Supply Pension Scheme
FSA
Law Debenture
Law Society of Scotland
Jonathan Seres
Society of Pension Consultants