

A Review of Pensions Institutions

Paul Thornton

**An independent report to the
Department for Work and
Pensions**

June 2007

Department for Work and Pensions

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Foreword

When I was first approached to carry out this review, I was not immediately aware of any significant problems arising from the current arrangement of pensions institutions, although it was an apparently complicated set up.

The institutional landscape encompasses a range of Government sponsored bodies with various responsibilities for work-place pensions – including regulation, advice, mediation, dispute resolution and compensation. Over the next few years the planned introduction of the new scheme of Personal Accounts and the outcome of the Thoresen Review will also have implications for the pensions landscape.

In the light of these developments the Government asked me to take stock of the current framework and to make recommendations for the best arrangement of responsibilities going forward.

Given the instructions to have regard to the principles from the Hampton Review, there was a need to consider whether any bodies might be combined. Not surprisingly the Pensions Regulator, with its broad set of objectives for providing security for people's occupational pensions, made the case for combining with the Pension Protection Fund, and the Financial Ombudsman indicated a willingness to take on the functions of the Pensions Ombudsman.

Apart from examining the arguments for and against these particular propositions, I have looked closely at the effectiveness of the interactions between all of the bodies in my terms of reference, in what is overall something of a jigsaw of different roles. There was less overlap and duplication than I expected, with well thought-out arrangements for co-operation and co-ordination throughout.

There is no evidence to suggest that the current arrangements are not fit for purpose, but I have concluded that there are ways in which they could be made more efficient and effective.

In the final analysis, the three most significant areas where I think changes are needed are:

- **to underpin the close co-operation and co-ordination which already exists between the Pension Protection Fund and the Pensions Regulator.** I have concluded that, notwithstanding some potential benefits from combining the two bodies, this would not be helpful at such an early stage in their development. There are no significant difficulties arising from their operating separately, so far. I have instead made recommendations designed to underpin closer working.

- **to further develop the joint working between the Financial Services Authority and the Pensions Regulator in the area of work-based defined contribution pensions.** I have concluded that there is a need for greater clarity on the respective roles of the two bodies, with a more holistic approach to regulation of DC schemes.
- **to transfer the office of the Pensions Ombudsman into a new Pensions Jurisdiction in the Financial Ombudsman Service.** I have concluded that the current arrangements could be streamlined and made more robust by integrating the functions of these two bodies.

I have been highly appreciative of the constructive spirit in which the various institutions and stakeholders, including DWP and HMT have co-operated with the review, whatever their views on some of the issues covered, and I am also greatly indebted to the DWP team appointed to assist me, Anne Packer, Rob O'Carroll and Jimmie Yardley, who have ensured that the necessary input was gathered, meetings arranged, consultation achieved and papers drafted with great efficiency over a very compressed timescale.

Paul Thornton
June 2007

Summary

The Review

1. My remit has been to undertake an independent review of organisations involved in the regulation and protection of workplace pensions:
 - to consider how the responsibilities of the pensions institutions are arranged, including those of the Pensions Regulator (TPR), the Pension Protection Fund (PPF) and the aspects of the Financial Services Authority's work (FSA) covering regulation of work based pensions, to ensure that they support existing Government policy, fit with pension reform proposals and with developments in the pensions market;
 - also to consider the provision of advice, dispute resolution and compensation. This involves the pensions functions of the Pensions Advisory Service (TPAS), the Pensions Ombudsman (PO), the Pension Protection Fund Ombudsman (PPFO), the Financial Ombudsman Service (FOS), the Pensions Regulator Tribunal (TPRT), and the Financial Services Compensation Scheme (FSCS).
2. The PPF and TPR have now been in operation for two years, working alongside a range of other pensions bodies established between 1983 and 2005. It has been good governance to review the pensions institutional landscape at this stage, given the changing pensions world. The review has encouraged the pensions institutions to reflect on how they are working together to common purpose, while enabling stakeholders to contribute their insights.
3. The aim has been to recommend the best distribution of functions for the foreseeable future, so as to provide clarity, efficiency and effectiveness, and to avoid undesirable conflicts of interest, gaps or unhelpful overlaps in functions. Part of my role has been to encourage debate and build consensus on the best way forward. I have received views from and have met with the pensions institutions and their stakeholders. I have used web pages to publicise the review, seek input, and share submissions.
4. In coming to the review, I was not conscious of particular problems with the present arrangements, and I have seen no evidence to suggest the current distribution of functions is not 'fit for purpose' or does not support Government policy. But I have concluded that there are ways in which the bodies could be streamlined to provide an even stronger base for dealing with the changing landscape effectively and efficiently.

5. I make specific recommendations:

- to institutionalise the effective co-operation and close working between PPF and TPR
- to develop further the current joint working arrangements between TPR and FSA, particularly in relation to DC regulation
- to bring the functions of the Pensions Ombudsman - and with them the functions of the PPF Ombudsman - within the FOS

Consultation issues

6. In January 2007 I set out initial questions for stakeholders and the institutions. My consultation paper on 7 March sought further evidence on three particular questions that had emerged:

- Is there a good case for bringing TPR and PPF closer together?
- Is there a good case for bringing the FSA and TPR closer together?
- Is there a good case for bringing the PO and the FOS closer together?

7. In issuing my paper, I indicated that I had not yet come to a view on the TPR-PPF and FOS-PO issues, but on FSA-TPR aspects I did indicate my initial view that a change in functions - as distinct from improved working together - was not a pressing issue. But I stressed that these thoughts were provisional, and I set out and invited comment on all the arguments that had been put to me, both in favour of bringing the bodies closer together and of making no change in the current arrangements.

Principles

8. My consultation paper suggested key principles in weighing up proposals for change in the distribution of functions:

- encouragement of good private pension provision
- maintenance of confidence in the private pensions system
- an effective and comprehensive approach to risks
- clear accountability and effective governance
- avoidance of gaps, conflicts of interest or unhelpful overlaps between the various institutions
- ability to cope robustly with future developments
- clarity
- customer focus (including employers, pension scheme trustees, administrators, advisers, and scheme members and beneficiaries)
- costs and benefits of change
- control over the cost of levies to levy payers

These principles have underpinned my analysis, conclusions and recommendations.

9. I have also had regard to the Hampton principles; the key ones for the purpose of this review being reducing the number of regulators where possible to avoid duplication of effort and division of responsibility, and enabling a holistic approach to risk assessment.

Stakeholder input

10. I received input from all the key stakeholders, including groups representing employers, trustees, unions, advisers, product providers and pension schemes. Their comments confirmed that customers of the pensions institutions felt that the PPF and TPR had taken up their work enthusiastically, were handling their challenges well, and were carrying out their remits effectively.

PPF and TPR

11. It is clear that PPF and TPR have ensured that they work together at all levels in a systematic and effective way. I have been impressed that they co-ordinate resources effectively in a range of areas including IT systems, levy collection, clearance, use of data, the risk model and research.
12. The firm and virtually unanimous view of stakeholders is that the two bodies should not be combined, either because it is too soon to contemplate changes, or because their functions are intrinsically different and should not be combined.
13. I have considered carefully the extent of overlap and synergies and concluded that there is only limited overlap of function, and that because the interactions are arranged well, the potential synergy from merger is fairly limited – less than might seem the case at first sight.
14. Merger could lead to some staff savings, particularly in areas such as HR, IT, communications, finance and stakeholder / customer support. There would be savings with a single Board in place of two. An analysis carried out for DWP concluded however that the scope for reducing staff numbers and cost savings was limited. At the same time, there would be short to medium term costs, and the key regulatory, investment and levy functions would need to continue whether within one body or two. In the light of this, I consider that decisions should primarily be driven by policy and practical considerations.
15. Whilst in my view a combined body would be able to do the job, I have concluded that the present structure is working successfully, and a strong case would have to be made for merger, from the starting position of having separate bodies. Given the effective start both bodies have made, the firm and near unanimous view expressed by stakeholders, and the risks in a transition, I have concluded that they should remain separate, with the present configuration of functions, which I consider is providing clear governance,

avoiding duplication and conflict of interest, and enabling the functions to be arranged efficiently and effectively.

16. At the same time, there is scope to strengthen the existing co-ordination arrangements. I have recommended arrangements to institutionalise co-operation and ensure even closer working between the organisations. These include appointing an additional, shared, non-executive member to sit on both PPF and TPR Boards, and establishing a formal Pensions Institutions Forum chaired by a senior independent person, to discuss key current and emerging issues relevant to a number of bodies. I also suggest that the Forum might ask the Government to review TPR and PPF and also the other pensions institutions some 5-10 years hence, by which time it should be clearer whether there are problems attributable to the separation of the functions, in the light of developments in pensions reform and external changes in the pensions world.

TPR and FSA

17. TPR and FSA are, together, responsible for the regulation of private pensions. They regulate different communities and their approaches differ, reflecting their objectives and powers. TPR regulates work-based pensions, including promoting good administration of those schemes. FSA regulates the sales and marketing of personal pensions, including stakeholder pensions, and annuities. So there are areas of common interest and overlap, for example in relation to contract-based work-based schemes.
18. A Memorandum of Understanding sets out the current boundaries, which appear to be well understood by the two bodies, and there are arrangements for co-operation and exchange of information.
19. The evidence has confirmed that there are no deficiencies in the current structure of pensions regulation, and that pensions and financial services are substantially different in their regulatory context. TPR has close links with employers and trustees, whereas the FSA is mainly concerned with companies and friendly societies.
20. It would not be possible to alter the current boundary of functions without creating new areas of overlapping responsibility, and FSA and TPR have indicated that they do not favour change. Stakeholders also show a clear preference for retaining both bodies.
21. There was, however, considerable comment from stakeholders on the need for closer liaison between the two bodies and a more holistic approach, particularly to regulating DC schemes. FSA and TPR have already put arrangements in place to assist co-operation and co-ordination on areas of mutual interest. I make proposals to bolster these arrangements: the two regulators should provide some combined source of information, with some joint communications and consultations, and enhance the arrangements for

consumer and practitioner input in the areas of mutual interest and overlap: particularly DC schemes.

22. The review has taken into account the international perspective, potential capital market solutions and the planned development of Personal Accounts. Key findings are that:
- the current regulatory system is fit for purpose, and the division of functions between the FSA and TPR works in practice
 - there is a need for greater clarity on the role of the two bodies, with a more holistic approach to DC regulation
 - the current boundary arrangements will need to be kept under review, in the light of changes to the regulatory environment and market developments

FOS and PO/ PPFO

23. Taken together, the PO and the FOS provide a comprehensive service for resolving pensions complaints and disputes. Disputes involving pensions are often far from straightforward, with a significant number of complaints involving multiple parties and investigations going back some years.
24. The level of complaints is not always easy to predict, and business planning and flexibility to redirect resource – in particular for small scale organisations such as the PO – presents significant challenge. Most stakeholders are not aware of any difficulty among consumers arising from the distinct roles of the two ombudsmen, but other stakeholders consider there is some evidence of confusion.
25. There is a Memorandum of Understanding between the PO and the FOS which shows a clear distinction of responsibilities between the two offices. There are some overlaps on personal pensions, with effective processes in place for redirecting cases. Both institutions refer a significant number of cases to TPAS' dispute resolution service.
26. Retaining the two separate bodies in their present form does not seem to provide the optimal outcome for effective and efficient management of pensions complaints and disputes. Reasons include:
- the small scale of the PO's office can lead to difficulty in managing the flow of work
 - the current separation of the two bodies seems historical, not essential, and seems to have continued, at least to some extent, on the basis that FOS's remit focused primarily on those firms authorised by the FSA
 - although there is no corresponding recommendation to combine regulators, an ombudsman is independent of a regulatory body, not part of the same

structure, and within a combined Ombudsman service I envisage a separate, free standing jurisdiction for pensions

27. I conclude that the PO should be fully integrated within the FOS, to provide the advantages that a large organisation brings in terms of resource, flexibility and economies; in line with Hampton principles. It is important that the differences in the current statutory arrangements for the PO and the FOS are worked through systematically, to determine whether they should be harmonised or whether there is a good rationale for preserving them. I recommend that the role of TPAS is allowed for in the revised ombudsman arrangements, so that it can continue to provide its present enquiry and mediation service.

TPAS

28. TPAS provides a low cost service through its staffing of around 500 volunteers, in addition to its paid staff, handling substantial volumes of queries, and resolving pensions disputes quickly and effectively. The current structure of TPAS works well and I have seen no evidence that it should be altered. TPAS is predominantly a voluntary organisation. There is great social and financial value in this and it gives the body a unique place in the UK pensions landscape.

29. A number of wider changes, including the development of Personal Accounts and the Thoresen work on generic financial advice, are likely to be significant for TPAS outside the timeframe of my review. I commend TPAS to those involved in formulating policy in these areas.

TPRT and FSCS

30. My discussions and the written evidence from the institutions and their stakeholders have confirmed the tentative conclusions in the consultation paper: that the roles of the FSCS and TPRT are clear, and that there is no need to revise their functions and boundaries.

Recommendations and conclusions

31. My recommendations and conclusions are at Chapters 3 and 4.

Chapter 1: Introduction; current framework; how I took the review forward

Introduction

1. On 16 January 2007 the Government announced my appointment to undertake an external review of organisations involved in the regulation and protection of workplace pensions. I have been asked to look at how the responsibilities of the pensions institutions, including the Pensions Regulator (TPR), the Pension Protection Fund (PPF) and the aspects of the Financial Services Authority's work (FSA) covering regulation of work based pensions, are arranged to ensure that they support existing Government policy, fit with pension reform proposals and fit with developments in the pensions market.
2. Alongside regulation and protection, my remit has also included provision of advice, dispute resolution and compensation. This has involved the pensions functions of the Pensions Advisory Service (TPAS), the Pensions Ombudsman (PO), the Pension Protection Fund Ombudsman (PPFO), the Pensions Regulator Tribunal (TPRT), the Financial Ombudsman Service (FOS) and the Financial Services Compensation Scheme (FSCS).
3. My terms of reference have excluded administration arrangements for the Financial Assistance Scheme (FAS), and I have therefore considered it only to the extent that it impacts on other bodies.
4. I have been asked to report the findings of the review and make recommendations to Government in Spring 2007. The full Terms of Reference for my Review are at Annex A.

Current institutional framework

5. Short descriptions of the remit of all the bodies under review are at Annex B. They can be described as bodies whose prime focus is **regulation**: the Pensions Regulator and Financial Services Authority, **dispute resolution**: the Pensions Ombudsman, the Financial Ombudsman Service, the Pensions Regulator Tribunal and the Pension Protection Fund Ombudsman, **information provision**: the Pensions Advisory Service, and **compensation**: the Pension Protection Fund and the Financial Services Compensation Scheme.
6. TPR, PPF, TPRT and PPFO were all established by the Pensions Act 2004, and became operational in 2005. The PO was established more than a decade earlier, under the Social Security Act 1990; the FSA, FOS and FSCS under the Financial Services and Markets Act 2000; while TPAS is not established under statute, but dates back to 1983.

Context of Review

7. The context for the review is that the PPF and TPR have now been in operation for two years since their formal establishment in April 2005 under the Pensions Act 2004, working alongside a range of other bodies which also have pensions functions.
8. It has been good governance to have a review of the pensions institutional landscape at this stage. The Pension Protection Fund and the Pensions Regulator have now been operational for two years; pensions information and complaint provisions have been delivered through their current structures for a number of years; and meanwhile the pensions world is changing substantially, for example:
 - The planned introduction of Personal Accounts may give a new role to TPR in a few years' time. The extent and nature of possible regulatory requirements are not yet fully clear, so I have only been able to take them into account to the extent that I have been informed about them; it is not anticipated that any change will be sufficiently significant to affect my deliberations in this review.
 - Developments being mooted in capital markets, such as partial annuity buy-out; longevity hedging instruments; capital solutions which do not involve annuity buyout; credit insurance. These would alter the risks carried by pension funds, and by the PPF in underpinning them.
 - The extent of FSA's role in regulating pension-related financial products could well increase, for example as a result of annuity buyouts.
 - The external deregulatory review may propose changes which impact on TPR and other pensions institutions. I have been keeping closely in touch with the reviewers.
 - The financial capability review, including work by the Thoresen review, announced by HM Treasury earlier in 2007, to examine the feasibility of delivering a national approach to generic financial advice, which could have an impact on TPAS and other pensions institutions.
9. The Review has also encouraged the institutions to reflect in a systematic way on how they are working together to common purpose, and to consider how they can work together even better in future. Stakeholders, for their part, have taken the opportunity to share their insights and to contribute to a study of the new and not-so-new organisations.

10. I have been grateful for the active co-operation of the institutions under review and the very constructive discussions and written input throughout the various stages of my Review. The written submissions are available on the Review website.
11. Further copies of this Report are available from the secretariat to the Review of Pensions Institutions, 3rd floor, The Adelphi, 1 - 11 John Adam Street, London, WC2N 6HT. It is also online at: www.dwp.gov.uk/pensionsreform/institutional_review.asp along with further information about the review.

How I took the review forward

The initial stages: January and February

12. In undertaking the review, my aim has been to consider the best distribution of functions for the foreseeable future, to provide clarity, efficiency and effectiveness and to avoid undesirable conflicts of interest, gaps or unhelpful overlaps in functions.
13. As part of my role, I have been asked to encourage debate and to build consensus on the best way forward, and I therefore sought views from a wide cross-section of stakeholders and have engaged actively with the pensions institutions. I explained that I planned to publish contributions sent to me during the consultation, as in my initial stage of seeking input, so as to broaden discussion and reach a shared understanding of the issues and views on the way forward.
14. Immediately after my appointment in January, I set out my initial questions, which are at Annex C. I put these on the review web pages and contacted a substantial number of stakeholders with a potential interest in this area. During January I also met key people in each of the nine bodies involved in the pensions area, as listed in my terms of reference.
15. I had discussions with senior staff and with Board members of PPF, TPR, FSA, FSCS and TPAS in January and February. I also had discussions with the Pensions and PPF Ombudsman and Deputy Pensions and PPF Ombudsman, with the Chief Ombudsman and senior staff of the Financial Ombudsman Service, and with the President of TPRT. In addition each of the bodies sent me written submissions setting out the evidence from their perspective for the first stage of my review.
16. I have also consulted with others with a knowledge of the issues. So I sought initial evidence and views from as many people and organisations as possible, asking them to let me have their initial input by 9 February.

17. There are likely to be significant changes in the pensions landscape over the next few years, and I therefore sought views on how the following issues might impact on my Review.

- The introduction of Personal Accounts, proposed from 2012, will create fresh regulatory issues and workload, and may create a new role for TPR in a few years' time.
- One can anticipate the development of longevity hedging instruments and the creation of capital market solutions for transferring pensions risk, and there are already new annuity buyout firms. Employers are looking at ways in which the risks inherent in occupational pension schemes can be shared with members, and new 'risk-sharing' designs of occupational pension scheme can be expected to develop.
- On the international front also, there are developments on the horizon. The European Commission is expected to seek advice in 2008 from The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), on the potential implications of Solvency II - the European Union review of the current insurance Directives - for pension funds.

Consultation on emerging issues: March

18. Following on from my initial questions, on 7 March I published a consultation paper on emerging issues, seeking further evidence by the end of March. I identified three particular questions that had emerged, which all seemed worthy of careful consideration, and on which I focussed during consultation:

- *Is there a good case for bringing TPR and PPF closer together?*
- *Is there a good case for bringing FSA and TPR closer together?*
- *Is there a good case for bringing the Pensions Ombudsman and the Financial Ombudsman Service closer together?*

19. In the consultation paper I set out the key points that had been put to me (Annex D) and I sought further evidence and views by the end of March, so that I could take account of these before making my recommendations to Government. The invitations to make initial input and to respond to consultation inevitably involved quite short time periods because of the timescale for my review.

20. Setting out the arguments that had been put to me both in favour of bringing the PPF and TPR closer together and of making no change in the current arrangements, I deliberately approached this in a neutral way, despite the very strong views put to me from some quarters.

21. I also set out the arguments that had been put to me in favour of bringing TPR and FSA closer together and of making no change to the current arrangements. The evidence provided by both TPR and the FSA at the outset of my Review suggested that the current boundary was appropriate and I indicated my initial view that the balance lies in favour of retaining the status quo: that change in functions – as distinct from joined up working and clarity – does not seem to be a pressing issue.
22. Setting out the arguments that had been put to me in favour of bringing the PO and FOS closer together and in making no change to the current arrangements, I approached this in a neutral way.
23. I received a substantial number of responses, which have been very useful in broadening understanding of the issues. (The contributors are listed in Annex E).
24. During March I held further meetings with the pensions institutions, and took the opportunity to visit the offices of the PPF, TPR, PO, FOS and TPAS, including discussions with a range of people, to learn more in depth about the organisations and their work.
25. I also arranged a joint meeting with around 20 key stakeholders of the institutions towards the end of the consultation period, to share and compare their assessments, and I am grateful for those valuable insights.
26. In addition I received approaching 40 written responses from a good cross-section of stakeholders. These included groups representing employers, trustees, unions, advisers, product providers and pension schemes.

April: Emerging conclusions

27. I have seen no evidence to suggest that the current arrangements for distribution of functions between the various institutions in the pensions landscape are not fit for purpose or do not support Government policy. But I have concluded that there are ways in which they could be streamlined to provide an even stronger base for dealing with the changing landscape effectively and efficiently.
28. The input from stakeholders has confirmed that customers of all the pensions institutions see the bodies as functioning effectively within their remits, and the feedback I have received has confirmed the initial indications in my March consultation paper that PPF and TPR - Pensions Act 2004 new bodies - have moved both fast and effectively to respond to their challenges.
29. During April, I drafted the report. In developing my conclusions and recommendations, I have given all the institutions within my terms of reference the opportunity to comment on successive drafts of the report, to ensure that I developed my work on a 'no surprises' approach, aiming to build consensus as far as possible.

Research commissioned by DWP

30. DWP offered to commission research, in order to inform my review and Departmental thinking, and which would broaden the evidence base, to give a cost-benefit analysis if PPF and TPR, TPR and FSA, and/or FOS and PO were brought closer together. This approach has added a further dimension to the review, alongside my policy analysis.

Chapter 2: Key underlying principles and factors for the review

1. In the March consultation paper, I offered for discussion some key principles that seemed to me important in weighing up proposals for change. I asked for comments on these and whether any further factors should be added.
2. The consultation has confirmed that I had appropriately identified the principles: two comments were received from one stakeholder but there were no principles that people thought should be set aside. Using these principles has been very helpful for my review. They have underpinned the analysis which I have undertaken, my conclusions and the recommendations which follow.
3. The principles are:
 - encouragement of good private pension provision
 - maintenance of confidence in the private pensions system
 - an effective and comprehensive approach to risks
 - clear accountability and effective governance
 - avoidance of gaps, conflicts of interest or unhelpful overlaps between the various institutions
 - ability to cope robustly with future developments
 - clarity
 - customer focus (including employers, pension scheme trustees, administrators, advisers, and scheme members and beneficiaries)
 - costs and benefits of change
 - control over the cost of levies to levy payers
4. The two comments were:
 - customer focus should include the impact on schemes of any changes to the regulatory environment, looking specifically at the cost and benefit of any change in relation to pension schemes; and
 - there should be an analysis of the speed of response and delivery of decisions, looking at the various institutions' response rates, identifying where delays occur and why the delays are occurring.
5. In addition, I have had regard to the Hampton principles. The key Hampton principles for the purposes of this review are: reducing the number of regulators where possible to avoid duplication of effort and division of responsibility, and enabling a holistic approach to risk assessment. I have interpreted "regulator" broadly for this review.

Chapter 3: Analysis and Recommendations

Section 1: The PPF and TPR

Introduction

1. This section of the Review considers TPR and the PPF. Responses to consultation from a broad range of bodies have confirmed my conclusion that there is nothing problematic in the current arrangements. The question is whether there is useful scope for streamlining the interaction of the bodies in some way.

The bodies separately

2. My consultation paper has already noted that each body has got off to a good start since being established in April 2005. For example:
 - TPR has made a very successful transition from its predecessor body, Opra, and is well regarded for its professional approach to risk based regulation. It has, for example, handled a large number of clearance applications speedily, and has extended its focus beyond DB schemes with a recent consultation on regulation of DC schemes.
 - PPF has successfully implemented a risk based levy system earlier than expected. PPF's approach is widely considered to be effective and responsive to consultation inputs on levy plans. PPF is already a major player in financial markets, and now nine schemes, with 7,000 members, have moved through the assessment period into PPF compensation, with a further four coming out of assessment in other ways.
 - Both bodies are in the process of developing their roles, functions and powers, and neither has suggested material changes are needed to their respective regulatory and compensatory functions and powers.

The bodies working together

3. Looking at how the bodies work together, it is clear to me, and confirmed by stakeholders, that TPR and PPF have ensured that they work well together at all levels in a systematic and effective way, particularly in the light of experience over the first year or so of operation. This has been reflected in a Memorandum of Understanding.
4. During the first year or so, while the organisations were very new, they inevitably had a steep learning curve to establish and embed their arrangements working effectively together. They have both moved up that curve, and I agree with their analysis that the bodies are working successfully

to ensure they deliver effective ongoing co-ordination. I do not see this as likely to change, but it is very important that it does not change.

5. In the early months I also understand that there was a measure of uncertainty among their customers around the respective roles of each body, for example when both were undertaking early consultations. However the evidence from stakeholders indicates that people now have a much clearer view of the roles and functions of each of the bodies and the distinctions between them. There is no obvious evidence of confusion caused by having two separate bodies.
6. I have looked carefully at their arrangements for coordination, which include regular joint meetings and a tripartite Memorandum of Understanding (which includes DWP). I have discussed shared working on projects such as the joint 'Purple Book' on risk, published in December 2006. These arrangements all seem to me appropriate. There is also close coordination and cooperation over such matters as the collection of scheme data, levies, collection of research information, IT systems and the use of risk models.
7. DWP has an ongoing role in stewardship of the two bodies. From my discussions, I conclude that this has provided substantial additional underpinning to the way the bodies have developed successfully together in their formative years. The tripartite Memorandum of Understanding and quarterly tripartite meetings help ensure that issues at strategic and operational levels are co-ordinated across the three organisations if and when they need to be.

Stakeholder input to the Review

8. The overall view of stakeholders, expressed both at the meeting I held in March and in their written submissions, is firmly that the two bodies should be left to operate separately, and that it is too soon to contemplate changes.
9. Stakeholders show a strong preference for retaining both bodies with their current configuration of organisational responsibilities, pointing out that merger could consume considerable resources during a transition, which could distract the bodies from their core functions and detract from work on other important upcoming priorities; both bodies have a lot on their plates, including PPF's increasingly large scale investment role, and TPR's continued development of its role in clearance and with DC schemes, and a likely - though potentially not particularly extensive - new role in regulating the Government pension reforms for planned new Personal Accounts. More concern has been expressed about the involvement of both TPR and FSA in the regulation of DC schemes than about any overlaps between TPR and PPF, or any problems created by the two bodies being separate.

10. Some quotes from the stakeholder groups identified above, which show near – though not full - consensus from consultation responses are:

Confederation of British Industry: “Consultation with CBI members indicates that there is little or no appetite for institutional change. The CBI opposes the proposal to turn TPR and PPF into a single organisation. Both organisations are relatively new and have further development of their functions to undertake...unnecessary change now would distract attention and resources from these core functions. The CBI believes the present regime is working well.”

Trade Union Congress: “While of course there should continue to be good relations between these two organisations, we are strongly opposed to any proposal to merge them. We see little or no advantage from any merger, but strong disadvantages and potential conflicts of interest from bringing their roles together in a new body.”

Association of British Insurers: “The ABI does not believe there is a case for merging the PPF and TPR. It is too soon to consider this sort of structural change. Merger would be an unnecessary diversion from the core activities of these institutions and could disrupt the positive reputation that they are building. The Institutions Review should also bear in mind that the costs of transition would have to be borne by pension schemes, putting them under additional pressure. More fundamentally, it is important to be aware of a conflict of interest between the roles of the two institutions.”

National Association of Pension Funds: “We do not think the PPF and TPR should be brought closer together. We feel that having a regulator and compensator as one body would create conflict of interest.”

Institute of Chartered Accountants in England and Wales: “We believe that there should be a separation in the role of protecting pensions and that of the administration of a pool of assets and paying compensation. These are quite separate functions.”

Association of Consulting Actuaries: “As a basic principle we believe that it is too soon after the introduction of these bodies to make a major structural change.”

Legal & General: “The two organisations have radically different functions and we can see only increased risks by bringing them together. We agree that there is benefit to be had from the two organisations working closely together.”

Prudential: “We believe that the objectives of TPR and PPF are significantly different and, as a result, do not believe that merger is appropriate...we also feel that it would be too soon to merge. The separate organisations are developing well and need time to focus on their respective objectives before the

diversion of merging was imposed. Any merger would have to be subject to a cost benefit justification, which we are intuitively not convinced exists. We do however believe that where there is a commonality of interest then PPF and TPR should work together to reduce costs both for themselves and for industry.”

Independent Trustee Services: “From ITS’s perspective there is a clear need to maintain separation of the functions.”

Morgan Stanley: “We understand the logic for bringing TPR and the PPF closer together. However we question whether the timing is right. Both bodies appear to have had good starts and there may be risks associated with too great a change at such an early stage in their development.”

In the other direction, **Watson Wyatt said:** “Merging the two institutions does seem to present opportunities to produce greater efficiencies in relation to both information and knowledge sharing.”

11. Stakeholders have also commented that they are unaware of another country where pensions regulation and compensation functions are combined.
12. Stakeholders made a range of specific suggestions, including: removal of TPR’s objective to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund; commending greater clarity about the roles of PPF and TPR during the (minority of) clearance applications to TPR in which PPF are also involved; data sharing. Two of these I follow up in my recommendations, but I have not taken up the idea of changing TPR’s primary objectives, as I believe this would have a detrimental impact on the way in which TPR carries out its functions.

The suggestion of merger

13. The idea of considering a merger was raised at the outset by TPR, which is understandable considering the breadth of its primary objectives. The case for a merger is essentially that a combined body would be able to take a more holistic view of the issues dealt with by TPR and PPF separately. TPR already has an objective to protect the PPF and a combined body which held both regulatory and compensation functions would enable a balanced view to be taken on how best to provide security in pension provision.

What would merger entail?

14. Merger to create a new body would need primary legislation. I consider that specific aspects to cover would include newly defined governance structures, functions and objectives, revising some of Parts 1 and 2 of the Pensions Act 2004 and Schedules to the Act. I understand that the earliest such legislation

could be enacted would be summer 2008, followed by a period for implementation.

15. In a merger to create a new body, existing responsibilities would need a planned transition – in order to make changes as seamless as possible for users. Any merger would for example involve advertising and appointing to a new joint board and to key posts in a new organisation, with a project to bring the organisations together into a cohesive new structure.
16. The bodies are not co-located: one in Croydon and the other in Brighton. If there were merger, the question of location would need to be addressed. Though a new body could probably function from its two current locations, and their separation might help the creation of the ‘Chinese Walls’ that would be needed, this might make it more difficult to realise the full benefits of a merger with a combined body working from a single location. However co-location would inevitably incur interim costs and disruption.
17. From my discussions with TPR, it was clear that they had studied the practicalities of a merger with some care, and recognised the need to deal with conflicts of interest. Whilst I have not in the event pursued these issues in any great detail, I formed the view that they could have made a merger work if this was to be my conclusion.

Merger or no merger?

18. **Simplicity/Accountability** - One of the arguments in favour of merger was that a single organisation for those affected by pension regulation or compensation would make for simplicity and better communication with users, as well as better accountability to Government. There is clearly merit in these points, although there was no evidence from stakeholders that in the second year of operation the current separation was causing problems for them. The present accountability is clear. While a combined organisation would make stewardship more straightforward for DWP, as it has a role for example in senior appointments, I consider that DWP already has proper governance controls in place for the current structure. I do not, therefore, believe that minor administrative simplifications should be the decisive element. Whilst intuitively attractive as an arrangement, I think the merit of reducing the number of bodies here is outweighed to some extent by the undoubted transparency of having a separate PPF focussed purely on its own functions.
19. **A comprehensive approach to risk assessment** - A single organisation would enable it to consider all the risks to pension schemes and their members and enable it to take a comprehensive approach. I believe this is a strong argument, and was surprised at how few stakeholders saw the value of this. Security for members’ pension benefits can be achieved by a combination of appropriate risk-based funding standards, a safety net, and contractual protection for the pension fund as creditor in insolvency proceedings. The creation of TPR is

designed to achieve the first of these and the creation of the PPF the second. However these are simply the 'belt and braces' which hold up the 'trousers' of pension commitments, and TPR's four main objectives include one to reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund. Bringing the two functions together could in principle enable balanced decisions to be taken when companies find themselves unable to finance their pension commitments, and seek clearance from TPR for some reconstruction or refinancing, even though it does mean that the process by which decisions are made is less transparent.

20. **Overlaps / synergies/ shared working** - I have considered carefully the extent of overlap and synergies, and have concluded that there is only limited overlap or duplication, and that because the interactions are arranged well, the potential synergy for merger is fairly limited – less so in practice than might seem the case at first sight. In practice the prime focus for TPR and PPF is different in areas where, on the face of it, there could seem to be overlap.
21. Whilst initial impressions might be that PPF focuses predominantly on the micro level, for example with individual schemes in assessment and going into compensation, and TPR on the macro level eg with funding levels, it has become clear to me that both bodies are involved in different ways at both micro and macro levels, but with little duplication. For example PPF considers insolvencies at a micro level, and the overall pension protection levy at a macro level, and TPR looks at schemes at a micro level in its clearance work, alongside its work at the macro level. This results in a considerable complementarity of the roles of the two bodies. There will continue to be some overlap and a need for the bodies to work together, but there does not seem to me to be sufficient of an issue here to be a major argument for merger.
22. I have been impressed that TPR and PPF co-ordinate their resources effectively in a range of areas, including IT systems, levy collection, clearance, the risk model and research, and use of data:
 - **IT** - Though PPF and TPR operate different IT systems, outsourced by PPF and in-house at TPR, the systems are compatible, and the teams have developed strong and effective links, including for example a strategy on maintaining and sharing data, and on portals, data maintenance and end to end processing. This minimises overlap and duplication.
 - **Levy collection** - TPR collects the running costs levies - which are based on the same calculation rules using membership numbers - for both organisations. The TPR levy also covers the running costs of the Pensions Ombudsman and of TPAS, and is levied on both DB and DC schemes. The amounts collected are returned by TPR to DWP, to recoup Government grants drawn down by the institutions at intervals each year. (In 2007-8, the PPF administration levy is expected to raise around £20m from PPF-eligible DB schemes, and TPR's general levy is expected to raise around £31m for

TPR/PO/TPAS – including an element of set up costs for both PPF and TPR.) PPF collects and invests its pension protection levy (which is an order of magnitude larger: around £675m planned for 2007-8). For the PPF, collection of the pension protection (risk and scheme based) levy is a crucial element of managing its assets and liabilities. The different calculations involved, relative complexity, different scale and different destination of the monies, seem to justify the current separation. However the bodies may want to keep under review whether there is scope for sharing collection arrangements in future.

- **Levies** - TPR have argued that a combined body would be able to use the levy to promote common objectives, using it as a tool to encourage better funding. The risk-based levy no doubt does serve this purpose, but PPF have been at pains to demonstrate that the overall amount is an actuarial assessment of what is needed to meet the risks faced by the PPF as a compensation fund. My reading of the stakeholders' comments is that they prefer this transparency to what could be a more opaque approach to setting the risk based levy by a combined body. If the PPF level of benefits equated to the full extent of accrued benefits in schemes, there might be a danger that the PPF level of funding would become the de facto funding target, but as this is not the case, trustees and pension schemes can be expected to set funding levels on broader considerations.
- **Clearance** - TPR has received a substantial number of clearance applications. PPF is only involved in those where the company is heading towards insolvency. It has had a role in around 1 in 10 clearance applications to date. Its specific role is to maximise the recovery for the PPF as a creditor, and it operates alongside TPR, which has a broader role. Some stakeholders however believe the respective roles could be made clearer.
- **Risk and research** - The work by PPF and TPR on risk and the Purple Book, and ongoing further research, demonstrates effective coordination.
- **Data** -With minor exceptions, which will be removed once TPR's planned scheme maintenance data system is implemented later in 2007, TPR is the single, once-only, collector of scheme information. Both bodies draw on this in a range of ways for their functions, based on a data exchange agreement between them.
- **Conflicts of interest** - PPF and a number of stakeholders have suggested that there could be a range of potential conflicts of interest if the two bodies were combined. I indicated in my consultation paper that this deserved close examination. I have considered this issue carefully through discussions and analysis.

23. The conflicts identified for a combined body were between acting as a regulator and an institutional shareholder, acting as a regulator and a corporate creditor, and between having a 'referee' role in scheme funding whilst actively intervening in schemes in assessment. Third parties could feel at a financial disadvantage, whilst the impact of a decision could disadvantage other institutional shareholders or other corporate creditors.
- For example if the PPF arm of a joint body acquired an investment shareholding stake in a company as part of its investment portfolio, it would be expected to exercise its voting rights. If the company applied to the TPR arm for clearance, there could be claims from other stakeholders that the body had inside information and undue influence.
24. An additional concern was that the need for a high pension protection levy could be seen as reflecting a regulatory failure in sufficiently increasing the funding of pension schemes. This could lead to pressures on the levy-raising arm of the body from the regulatory arm of the body to keep the levy low. The impact would not become apparent for a considerable number of years. (It has been put to me that having separate decision-making on interest rates (by the Bank of England) and on monetary policy (by HMT) ensures similar separation of decision-making.)
25. Whilst I take the point that in some instances the decision-making and challenge process would be less transparent within one body rather than between two separate bodies, I did not find this to be conclusive. A variety of other organisations and businesses have differing ranges of control, differing objectives to balance, and sometimes 'Chinese walls' to construct, and I think all of this would be feasible for the functions of private pensions regulation and pension protection.
26. It is interesting that the separation of the regulatory and compensation functions has been such a clear preference of stakeholders, and the avoidance of conflicts of interest has been advanced as one of the key reasons for this preference. I appreciate that PPF has stressed this point in its communications, but it has clearly resonated with stakeholders. It is also interesting to note that there have been few suggestions for TPR and PPF combining some elements only of their operation.
27. **'Organisational cultures'** - It has been suggested to me that PPF and TPR have differing 'organisational cultures'. This may be true, but in practice both organisations have drawn heavily on both private and public sector experience, and have attracted high calibre staff who are attuned to their organisations' objectives.

28. PPF sees itself as predominantly a financial institution, likely by the end of 2009/10:
- to rank amongst the largest carriers of financial risk in the UK: £7bn assets would rank PPF beside top UK pension schemes
 - with a risk transfer programme equivalent to a medium sized bank
 - one of the largest carriers of annuity risk
 - a significant investor in capital markets and hedging products
 - setting a robust levy to provide around 100% solvency
 - transitioning 60 DB schemes a year into PPF compensation
- PPF currently has around 130 staff.
29. TPR is larger, with currently around 320 staff, mostly in slightly larger teams than PPF. It has broader spans of management control, with decision-making more devolved through the organisation, based on its regulatory responsibilities. While both PPF and TPR have a policy of market testing and outsourcing as far as possible (eg compensation payment, IT), it currently suits TPR's needs better to keep more functions (for example IT support) in-house, as a result of its regular market testing and benchmarking.
30. The two bodies have been established separately and have developed distinctive identities. People have been recruited on the basis of their current structures, and so changing the structures now would have a range of implications, including for personnel in the organisations. Overall I believe the impact of merger would give rise to short-term human resource churn, which might be most acute in the most critical posts.
31. **Creating uncertainty and additional work** - However well managed, there is a risk that a merger process could undermine the excellent steps both bodies have taken to establish themselves as strongly credible players in the private pensions world over the past two years. There could be considerable uncertainty and churn - both for members of staff and for the pensions world more widely - until merger was completed.
32. **Impact on confidence** - A principle in my analysis has been maintaining confidence in the private pensions system. The consultation paper included arguments put to me that early organisational change could distract both bodies from building successfully on their initial achievements, impact delivery and undermine confidence in the 2004 Act regime. In responding, several stakeholders picked up the potential for reducing public confidence in the pensions system - at a time when the bodies are doing important work to restore confidence (eg with PPF now making compensation payments and TPR bringing a new focus on improving scheme governance). Since merger would be a major task for management, distraction from core functions and key developments could risk them 'taking an eye off the ball'. This, with the need to revise the 2004 regime, could undermine public confidence in the resilience of the pensions system.

33. **Classification** - Though both bodies are at arms' length from Government, they are classified differently from each other by the Office of National Statistics and the Cabinet Office: PPF is a public corporation, while TPR is a non-departmental public body (NDPB). I understand that this has implications for Government accounting for example, though I doubt whether this would constitute a major hurdle.

Costs and savings

34. Merger could lead to some longer term staff savings, particularly in areas such as HR, IT, facilities, communications, finance and stakeholder/customer support. The key regulatory, investment and levy functions would need to continue whether within one body or two, and numbers working in potentially shared areas are fairly small, so the scope for reducing staff numbers and cost savings looks to me quite limited. There would be savings from having a single Board in place of two.

35. Against this, there would inevitably be short to medium term costs:

- opportunity costs, including use of senior staff time for merger, alongside continuing to discharge ongoing functions and adapt to developments in the pensions world
- wider opportunity costs at Parliamentary level associated with making and implementing new legislation in an already busy legislative schedule
- costs associated with combining (especially in a single location), such as losing some existing staff and their expertise, recruiting and training new staff, appointing a new Board, project managing a transition, revising building lease contracts etc
- it is also worth noting that it is frequently found in business that the anticipated benefits of merger are not immediately achieved

36. I have had the benefit of the research study mentioned in Chapter 1, which was commissioned by DWP in parallel with my Review, which has looked at potential savings over the longer term and costs in the shorter term if the bodies were combined in some way. The research has indicated that there are no overriding savings or cost grounds which give a strong impetus in either direction: either towards making a change or not doing so. TPR and PPF had also formed (differing) views on the potential costs and benefits of a merger. Although it is important for cost savings to be taken into account, I have concluded that the cost savings should not be the sole driver: there would be substantial initial costs and savings would be for the longer term and not particularly high, and in the context of the scale of the total costs of TPR and PPF and eventual total assets of PPF, this is not a key driver. This is consistent with my view that there are no major overlaps and duplication.

37. This means that the decisions to be taken on whether or how to bring the bodies closer together should be primarily driven by policy and practical considerations - and that is the approach which I have followed.

Conclusions

38. I see no over-riding reason for having two separate bodies. It would be possible to have an umbrella pensions institution to include a range of relevant functions, including regulation and compensation. It would be simplistic to assume that such a body would simply have a regulatory and a compensatory function. No doubt its objectives would be drawn more broadly. Starting from scratch, a single body might well have been viable and I can certainly see some merits in having a single organisation. There are synergies, identified above, such as approaches to risk, and data use, and there would be scope for sharing services, rather than having separate small teams.

39. However, starting from the position of separate bodies which are functioning successfully, a strong case would now have to be made for creating a merger, to outweigh the risks in a transition:

- it is possible that a merger would impact adversely on confidence in private pensions among members and the public at a time when that confidence seems to be re-emerging; there could be a (mistaken) concern that there was a hidden agenda to weaken the protection provided by the PPF in some way
- senior management time would be needed for restructuring - displacing time for other priorities
- merger would involve substantial legislation that would have to be fitted alongside legislation for Personal Accounts - which is a high Government priority, likely to involve quite complex legislation, and requiring careful consideration by Parliament. This would need to be weighed against other legislative priorities

40. The evidence is that TPR and PPF can operate successfully without combining, and it is not clear that there is sufficient to be gained from merger. Given the effective start the bodies have made, both separately and in working together, I have concluded that on the balance of argument the best option is for them to remain separate, with the current configuration of functions. This is providing clear governance, is avoiding duplication and conflict of interest, and is enabling the functions to be managed efficiently and effectively.

41. I have considered whether there is any merit in a halfway house of some kind, with shared functions in certain areas. However this has not been proposed by either of the bodies, nor by any stakeholders and I feel that it is preferable to have the clarity of the two bodies being quite separate.

42. I conclude however that there is scope to strengthen the existing co-ordination arrangements to ensure that they continue to fit the Government's pension policies and reform proposals, and wider developments in the pensions market.

Recommendations

43. I have concluded that the best way forward is to adopt a package to institutionalise co-operation and ensure even closer and more effective working between the two organisations.

- **Shared non executive membership of PPF and TPR boards** - I believe that it would be valuable to have a non executive member sitting on both boards. This would facilitate liaison and coordination, and would underpin the bodies' co-ordinated approach to planning, knowledge-sharing and emerging issues. It would be preferable for this to be a new appointment: of someone not currently a member of either Board, who would be given specific responsibility for joint working. It has been suggested to me that there could be more extensive common membership, or even a joint Chairman. However I see this as inappropriate if, as I recommend, the two bodies are to remain separate. More commonality than is needed to underpin close co-ordination and co-operation could remove the clarity which is one of the arguments in favour of separation.
- **A standing invitation for attendance of the Chief Executive of TPR/PPF to attend the Board meetings of the other body** - to facilitate co-ordination at executive level (without formal rights such as voting rights or full membership). This would ensure that each body is fully aware of the priorities of the other, and would underpin the current regular meetings between the Chief Executives. It might be that in normal circumstances the Chief Executives would not feel it necessary to take up the invitation, but it would ensure there were no difficulties should they wish to do so.
- **Establishing a formal Pensions Institutions Forum** - to embed and formalise increased co-ordination between bodies and also coordination with DWP and HMT. In line with Hampton principles I would not commend creating an additional statutory 'umbrella' body, and I appreciate that informal arrangements already exist. However a formal structure of this kind would ensure appropriate co-ordination could always be relied upon in future. I conclude that a new body, chaired by a senior independent person from one of the bodies, such as a non-executive director from DWP's Pension Client Board, meeting perhaps once or twice a year, could give even greater impetus to sharing good practice and developing effective co-ordination, and view the impact of pensions reform and other developments holistically. The chairmanship might be subject to rotation. Annex F sets out some aspects it might address.

- **Publish a joint policy statement of the principles associated with data collection and sharing, and with information gathering**, to formalise the current arrangements. (This follows up a stakeholder recommendation.)
 - **Publish a joint statement of the respective roles and responsibilities of PPF and TPR** in those cases where PPF is also involved in clearance applications made to TPR. (This also follows up a stakeholder recommendation.)
 - **Alongside these measures, there could be further operational arrangements**, including:
 - a. **Holding an annual strategy day involving both Boards**, to ensure that both organisations continue to understand each other's perspective on key issues.
 - b. **Encouraging the ongoing regular interchange/ secondments of senior and other staff** between TPR, PPF and DWP, and the private sector, to increase knowledge and mutual understanding of respective functions and working methods. This has been particularly effective to date.
 - c. **Developing the tripartite Memorandum of Understanding (MOU)** between TPR, PPF and DWP, which would need revisiting as a consequence of these proposals, to incorporate these principles.
44. This package would provide useful tools for maximising synergies and underpinning the current excellent level of co-operation, whilst avoiding the downsides of major reorganisation: churn in the institutions, the need for a substantial package of legislation, and creation of unnecessary uncertainty in the wider pensions world.
45. I do also believe that the arrangements should be reviewed at an appropriate future time, perhaps after 5 years and no later than 10 years. The pensions landscape is changing quite rapidly and it should not be taken for granted that present arrangements, enhanced as proposed, will always be the most appropriate. The proposed Pensions Institutions Forum would be well placed to suggest to Government that it instigates such a review.

Section 2: The Pensions Regulator and the Financial Services Authority

Introduction

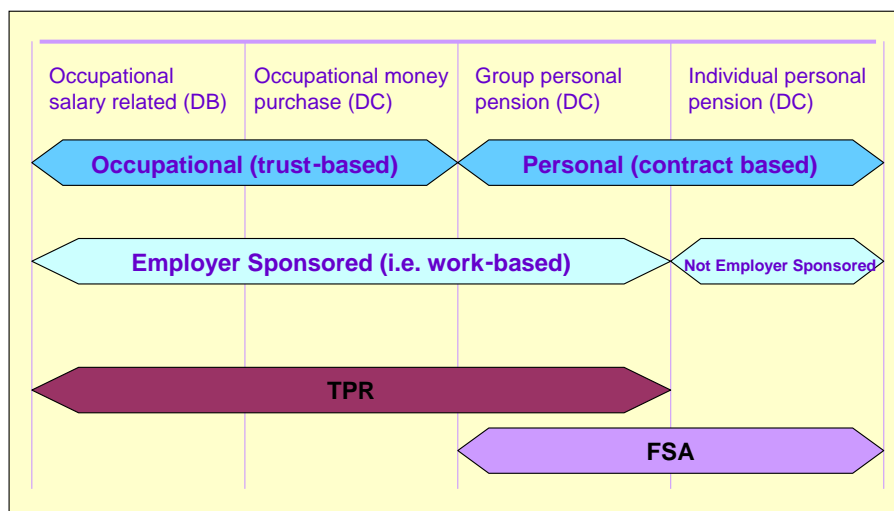
1. This section of the report considers the delineation of boundaries between the Financial Services Authority (FSA) in its pensions role and the Pensions Regulator (TPR). It makes three key findings:
 - the current regulatory system is fit for purpose and the arrangement of functions between the FSA and TPR seems to work well in practice;
 - however there is a need for greater clarity on the role of the two bodies - in particular it is important that the joint working arrangements, which already exist, are bolstered, with a more holistic approach to DC regulation;
 - the current boundary arrangements will need to be kept under review in the light of changes to the regulatory environment and market developments.
2. Responses to the consultation from a broad range of stakeholders have confirmed that there are no deficiencies in the current structure of pensions regulation. The evidence I have received confirms the view that pensions and financial services are substantially different from each other in their regulatory context and therefore require a different style of regulation – TPR has close links with employers and trustees in its regulation of work based pensions; whereas the FSA focuses on financial services, in its regulation of advice on and the sale and marketing of investments such as personal pensions and it is mainly concerned with companies and friendly societies.
3. The two bodies are relatively young and developing expertise – FSA was established by the Financial Services and Markets Act 2000 and TPR established under the Pensions Act 2004. My view is that it would be unhelpful, both to the regulated community, pension scheme members and consumers if the bodies were to be merged. Nor, on close analysis, would it be possible to alter the current boundary of functions without creating new areas of overlapping responsibility. The FSA and TPR have also indicated to me that they do not favour change.
4. There has been considerable comment from stakeholders during my Review, however, on the need for closer liaison between the two bodies in particular on the regulation of DC schemes and other areas where there is some –actual and perceived - overlap. There is however evidence that the FSA and TPR have already put arrangements in place to assist co-operation and co-ordination on areas of mutual interest, and I am encouraged by this. My report therefore makes recommendations to bolster these arrangements, with a series of concrete proposals designed to enable greater joint working between the two bodies.

The current framework: TPR and FSA

5. TPR and FSA (in its pensions role) are, together, responsible for the regulation of private sector pensions. They regulate different communities however and their approaches differ, reflecting their objectives and powers.
6. TPR is responsible for the regulation of work-based pension schemes, including the promotion of good administration of those schemes. FSA regulates the sales and marketing of personal pensions, including stakeholder pensions, and annuities. The following list sets out some of the differences between the two bodies:
 - The FSA and TPR were established by different legislation and in different legislative frameworks
 - Both bodies have different statutory objectives and consequently different priorities, which flow from the different legislation through which they were established
 - The FSA regulates licensed firms and has rule making powers and can enforce its rules through supervisory and enforcement action
 - TPR regulates work-based pension schemes, focussing mainly on employers, scheme trustees and managers and their advisers, by reference to provisions in primary and secondary legislation and codes of practice which have evidential status
 - The different objectives and powers of the two organisations reflects the different contexts in which they regulate: in the case of TPR the voluntary provision by employers of pensions; in the case of FSA the provision of financial services by firms for whom this is (on the whole) their core business
7. The FSA's and TPR's responsibilities in respect of private sector pensions are shown in *Fig 1*. The diagram shows there are some areas of common interest and overlap in relation to work-based pensions. Regulation of non work-based personal pensions is the sole responsibility of the FSA. Regulation of trust-based schemes is the sole responsibility of TPR. There is however a regulatory overlap in respect of contract-based schemes between TPR and the FSA.
8. There is a Memorandum of Understanding between the FSA and TPR. This sets out the current boundaries, which appear to be well understood by the two bodies, and describes the processes that are in place for cooperation and co-ordination of activities and exchange of information. There are regular meetings at senior management and at staff level, including ad hoc arrangements for resolving issues. There has also been joint involvement in communications - including guidance, policy and standards - which are

intended to ensure activities are complementary and achieve maximum effectiveness, although perhaps less visible than might have been the case.

Fig. 1



Stakeholder input to the Review

- Stakeholders show a strong preference for retaining both bodies: there is a clear sense that the FSA and TPR have different objectives and are responsible for regulation of different communities. Both are relatively new institutions; they are developing the expertise they need to achieve their different objectives. Bringing the functions of the two bodies together is likely to dilute the institutions' ability to meet their core functions – in particular if TPR were to be subsumed into the much larger FSA there might be a loss of focus on pension priorities. Stakeholders have, however, expressed concern about how joined up the two bodies are and in particular suggest that a more holistic approach should be adopted in relation to the regulation of DC schemes
- The following quotes show near – though not full - consensus from the consultation responses:

Prudential: “Our strong view is that, at this stage, it would be unhelpful to merge. However, more needs to be done to deliver effective joint working...Where there are shared responsibilities, there should be a jointly produced document of requirements adopted by all the regulators sharing responsibility.”

Standard Life: “We accept that there is a formal relationship between TPR and FSA governed by a memorandum of understanding, but we are concerned that this has little practical effect.”

Association of British Insurers: “The ABI does not believe that these organisations should be merged at this time. The costs of change – which would be borne by schemes – could well outweigh any benefits. There is, however, a strong case for more clarity on the boundaries between the regulators. As a general principle, regulation of employers should be for tPR as far as administration is concerned, and for the FSA in relation to advice to members and potential members. There should also be closer working between the two organisations. FSA and tPR should aim to reduce differences and inconsistencies between their approaches and reporting requirements, and could even be given a formal duty to work together.”

Confederation of British Industry: “CBI members believe the focus should be on developing a closer working relationship and tackling areas of regulatory overlap and gaps rather than institutional change. In our response to the Regulator’s consultation on the regulation of defined contribution schemes, we highlighted the risk of possible regulatory overlap, but also at possible regulatory gaps where neither regulator leads or takes responsibility.”

Investment Management Association: “The IMA would agree that the respective functions of the FSA and TPR should remain as now. In particular it would be most unfortunate if the Solvency 2 regime were applied to pension funds. It is the case that long term saving, including occupational DC provision, is moving increasingly towards a model based on investment rather than the risk pooling implied by DB provision and traditional with-profits saving products. But we agree that the focus of the two regulators is different...”

11. However, some stakeholders have observed that there should be more general change. The NAPF, for example, advocate a change to the current boundaries between the two bodies, while ICAEW feel that the FSA should become the sole regulator of savings in the UK, including pensions:

National Association of Pension Funds: “We do not support the merging or bringing closer together of TPR and the FSA. Each regulates different sectors, with the FSA having responsibility for a wide range of commercial financial service providers and TPR having responsibility for trust-based employer sponsored pensions and areas of stakeholder pensions. Rather, the NAPF believes the review should recommend a change to the boundaries between the two organisations in order to bring the regulation of workplace pensions under one regulator.”

Institute of Chartered Accounts for England and Wales: “...the way forward is for the FSA to become the sole authority to deal with all savings in the UK, including pensions. As part of its role, the enlarged FSA should consider whether there is merit in regulating third parties who undertake pension scheme administration. These organisations typically collect contributions from employers and pay pensions, handling cash and paying pensions, just as annuity providers do. At present, such administrators are unregulated, yet they have a crucial role in delivering pensions.”

12. My March consultation paper identified what appears to be a gap in coverage of regulation and supervision of Independent Financial Advisers advising employers on a transfer between one occupational scheme and another. This is also affecting redress for individual complaints because the Pensions Ombudsman and the Financial Ombudsman Service have no jurisdiction in these cases. I have written to DWP to bring this to their attention, as it may need legislative change.

Important considerations

13. My review has explored the following key issues in relation to the current FSA and TPR framework that I think need to be considered in weighing up any proposals for change, along with those factors I outlined in my March consultation paper.

Impact of international perspective

14. The following major developments will impact the European private pension market in the near future:
- A review of the implementation of the IORP Directive expected to be conducted by the European Commission the end of 2008
 - Political consideration in 2008 of the applicability of Solvency II to occupational pensions
 - The preparation and approval of the Portability Directive
15. I understand that CEIOPS has been preparing a report on aspects of the implementation of the IORP Directive which is expected to be published by the end of this year. This will analyse market developments following the IORP Directive. My consultation with CEIOPS has confirmed that the current UK supervisory structure - FSA and TPR - works very efficiently in their viewpoint. The current separation of the two agencies does not cause any problems in the fulfilment of the responsibilities of a competent authority regulated by the IORP Directive. Of course, the expansion of the scope of pension directives may mean that in future EU pension regulation may straddle both the FSA and TPR.

Impact of capital market solutions and regulatory arbitrage

16. There are likely to be significant changes in the pensions landscape over the next few years. In particular one can anticipate the development of longevity hedging instruments and the creation of capital market solutions for transferring pensions risk, and there are already new annuity buyout firms. Employers are looking at ways in which the risks inherent in occupational pension schemes can be shared with members, and new 'risk-sharing' designs of occupational pension scheme can be expected to develop.

17. Capital market solutions have developed in response to deficits in DB pension schemes: these solutions are generally aimed at sponsoring employers. Concern has been raised that this development may fall outside the scope of the current regulatory framework and enforcement regime. I have discussed this with both the FSA and TPR. I believe and both bodies have confirmed that the current regime is adequate and the institutions' powers are currently sufficient: where capital market solutions are insurance contracts, such as bulk purchase annuities for example, they will come within the remit of the FSA; other designs of occupational pension schemes would come within the remit of TPR. My review has not in this respect identified potential gaps in the current regulatory arrangements. It is possible that future market developments may mean that TPR might need additional powers, but if this were to arise TPR would be at liberty to bring this to the attention of the sponsoring Department.

Development of Personal Accounts

18. The creation of Personal Accounts from 2012 as well as the shift towards contract based pension provision will inevitably change the pension environment. This may create fresh regulatory issues and a changing workload for TPR.

Proposition

Retaining the status quo

19. The arguments for bringing TPR and the FSA closer together and for making no change to the current arrangements were outlined in my March consultation paper. On further analysis, I remain of the view that altering the current framework would not be appropriate at this time. The two bodies are responsible for regulating very different communities, with different objectives and priorities and I can see no reason for changing the status quo at this time. The situation will need to be kept under review in the future, particularly if there is greater involvement by the FSA in pension regulation as pensions move away from their historical DB preponderance.

The case against merging TPR and the FSA

- On balance, the core boundary between the two institutions is clearly defined (work-based or personal with an overlap on personal pensions arranged via the workplace). The FSA's pension role includes the regulation of sales and marketing of personal pensions and annuities and the prudential regulation of personal pension providers. TPR's remit involves after sales care and scheme regulation. Effective interactions have been established at both Board and working level to manage the interactions.

Continued

- There is no evidence to indicate that the current TPR/ FSA boundary arrangements are not working.
- Moving TPR functions to FSA would have significant downsides, in particular:
 - TPR and FSA have different approaches to regulation consistent with the different risks they are dealing with – consequently a merger would involve significant dislocation in the short term
 - It could be inconsistent with the current distinct approaches to the regulation of insurance and occupational pensions, which might increase the perception of risk of Solvency II implications for the latter – solvency requirements are currently evolving with work in development of the Solvency II Directive, and the implications for pension provision are expected to be considered over the next few years.
 - For the FSA to regulate both pension schemes and financial services businesses might create potential conflicts of interest, particularly on clearance procedures in relation to the DB schemes of financial services firms and FSA’s regulation of financial services.
- Although there have been some international/ European moves towards single regulatory bodies this is not necessarily the right approach for the UK, particularly given its large occupational sector, and there is no evidence that the current arrangements are not working.
- Pensions and financial services are substantially different from each other in the UK in their regulatory context, and require a different style of regulation. Though pensions are financial services, the context in which they are provided means it remains sensible to continue currently to regulate them separately.
 - The UK approach reflects occupational pension provision being intimately linked to social policy, and the fact that employer-provided pension funds are not comparable with other financial institutions. The employer covenant stands in place of solvency capital; historically pension provision has been a voluntary act by employers.

Bolstering joint working: FSA and TPR

20. There is evidence of effective arrangements in place to enable joint working between the FSA and TPR and I am aware of some good examples where both bodies have effectively co-ordinated activities. The MOU, which is regularly updated, is comprehensive: it sets out a broad framework for joining up

activities and there is regular contact between the two bodies at both a senior and at a working level to link up their respective work programmes.

21. The institutions have put in place some arrangements for coordinating activities, in particular in relation to supervision of DC schemes.

- In parallel to TPR's consultation on DC schemes it set up an industry working group made up of representative bodies, including the Financial Services Authority (FSA) and the Department for Work and Pensions (DWP) and industry representatives – this provides a useful forum for seeking views on issues relating to DC schemes and consistency of approach where there is an overlap of roles
- TPR/ FSA joint communications - the institutions have developed one joint consumer facing product, which was a fact sheet for consumers on understanding their annual pension statement
- DC regulation – TPR's 'Summary of responses to the DC consultation' indicates that it is working with the FSA in the development of future proposals to ensure seamless regulation that avoids gaps or duplication, and which provides greater clarity

22. On further consideration of all the evidence I have concluded that the best way forward is for the bodies to adopt a set of proposals to reinforce the current joint arrangements that they have put in place. The proposals are designed to embed a more holistic and practical approach to joint working between the two bodies, particularly in relation to DC regulation.

Recommendations

23. I propose the following measures are implemented to enable more joined up working between the two bodies:

- **Establishing a formal Pensions Institutions Forum** – my previous section recommended the establishment of a forum to co-ordinate institutional activity. The forum would provide the opportunity for more joined up working between regulators, providing a richer channel for communication, as well as resolution of issues and agreement on specific joint activity. This forum could suggest that Government initiates any review of the regulatory boundaries which might be considered appropriate in future years.
- **Combined information** - the institutions have so far developed one joint consumer facing product (a fact sheet for consumers on understanding their annual pension statement). Because both bodies have responsibilities that relate to different communities and different regulatory styles, it is important that information and fact sheets are developed on a case by case basis, with sufficient attention paid to the audience for whom they have

been produced. However, better signposting and linkage between sources would be helpful and in those areas of mutual interest it would be enormously useful for unified documents to be available. I recommend that both bodies work in partnership to produce a single, jointly endorsed electronic source with links to relevant information and guidance from the appropriate regulator for those aspects of DC regulation for which they are responsible. There would need to be clear signposts for the customer. This will provide the regulated community with greater clarity on the roles of the two bodies and more accessible and joined-up guidance on regulatory requirements.

- **Combined communications/ consultation/ surveys** – the institutions have already put structures and processes in place – through the industry working group, quarterly FSA/ TPR policy team meetings and MOU – to facilitate partnership working. I recommend that in those areas of mutual interest the bodies should develop jointly managed projects to create a common regulatory response on specific issues. These principles should be incorporated in the MOU.
- **Develop a Practitioner and Consumer Panel/ Group** – TPR has put in place a very positive arrangement for joining up activities through its industry working group on DC regulation. The FSA has independent consumer and practitioner panels, which are set out in statute. I recommend that TPR and FSA co-operate to develop arrangements, making use of these groups, to jointly address the areas where the two bodies have a mutual interest. This would provide a useful route for feedback on regulatory activities and it would help to inform those aspects of their work programme on which they need to work in partnership going forward.

24. It would be important to seek further feedback from stakeholders on these proposals before they are implemented.

25. This package would provide useful tools for building on the effective arrangements that the two bodies have put in place in order to maximise effectiveness and reduce – actual and perceived – burdens on the regulated community.

Section 3: The PO/ PPFO and the FOS

Introduction

1. This section of the report considers the current organisation of the Pensions Ombudsman (PO) and the Financial Ombudsman Service (FOS). It makes recommendations for bringing the two bodies closer together to create a simpler, more coherent structure, with more resource available, to deliver improvements in efficiency and effectiveness.
2. My review consultation paper identified that I had seen no evidence to suggest that the current arrangements for the distribution of functions among the pensions institutions were not fit for purpose from the viewpoint of stakeholders. Feedback received during the consultation period from a wide range of stakeholders has indicated that neither the PO nor the FOS is failing to meet their statutory objectives, although concern has been expressed about the timescales which have arisen in the past for resolution of some PO cases.
3. The evidence presented to me during the course of my review has, however, suggested that the current system could be streamlined by integrating the functions of the two bodies. This would provide a single point of contact for consumers and business and maximise resource devoted to pensions complaints.
4. I recognise that there are some important differences between the current statutory arrangements for the PO and the FOS. There is also an issue around the role of TPAS in its mediation of pensions, given that the FOS provides a mediation service of its own.
5. In addition, the Pension Protection Fund Ombudsman (PPFO) handles Pension Protection Fund cases and some Financial Assistance Scheme appeals; consideration needs to be given as to whether these could be handled within a combined arrangement.
6. While these aspects do not seem to present a fundamental obstacle to bringing the bodies closer together, they would require careful analysis in parallel with integration to ensure the right framework can be established.

The current framework: the PO and the FOS

7. Taken together, the PO and the FOS provide a comprehensive service for the resolution of pensions complaints and disputes; providing individuals with a means of redress, which is less expensive and less formal than the courts. Disputes involving pensions are often far from straightforward, with a significant number of complaints involving multiple parties and investigations that can go back some years. Both bodies provide an important and worthwhile

service with regard to pension disputes, without which some might otherwise go unresolved.

8. The nature of the Ombudsman business is such that the level of complaints is not always easy to predict however. Various factors, including social and economic forces, contribute to the incoming flow of work which can mean business planning and flexibility to redirect resource – in particular for small scale organisations such as the PO – presents significant challenge¹.
9. My Review has identified that:
 - there is a distinction between the responsibilities of the two bodies, although there are some overlaps in the area of personal pensions
 - most stakeholders are not aware of any difficulty among consumers arising from the distinct roles of the two ombudsmen, but other stakeholders consider that there is evidence of confusion – among consumers and within the pensions industry – over which ombudsman handles which pensions cases
10. There is a Memorandum of Understanding between the PO and the FOS which appears to be working well: it shows a clear distinction of responsibilities between the two offices. There are processes in place between the two bodies for redirecting cases, which appear to provide an effective means for ensuring complaints are referred to the relevant body. Both institutions refer a significant number of cases to TPAS which offers a service in resolving disputes.

Stakeholder input to the review

11. Stakeholder input to the review has been mixed:
 - on the one hand some stakeholders – including the Association of British Insurers and the National Association of Pension Funds – believe that the two bodies should remain separate as they cover different areas, although both indicate that there may be advantages in bringing the PO and the FOS together in some way, perhaps under the same umbrella

National Association of Pension Funds: “The NAPF can see no reason to change the functions of the PO and FOS. However, there may be scope to bring the two Ombudsmen under one umbrella organisation. The Ombudsmen have separate responsibilities, and should continue to operate in distinct units. However, we agree that there are resource limitations for the PO that could be overcome by bringing the two organisations together, thereby maximising the resources available.”

¹ Annual Report of the Pensions Ombudsman 2005/ 2006

Association of British Insurers: “In terms of the functions of the two Ombudsman schemes, there is not a good case for bringing them together. The Pensions Ombudsman deals mainly with maladministration and the Financial Ombudsman Service deals mainly with mis-selling cases.... Having said that, there could well be advantages in bringing together the PO and FOS on a single site, with shared common services and the option of more easily transferring resources from one scheme to the other as required. This should be considered carefully, whilst maintaining the distinctive features of the current arrangements.”

- some - including the Association of Pension Lawyers – believe that it may be difficult to align the different constitutions of the two bodies

Association of Pension Lawyers: “The sub-committee's view was that it would be very difficult to align these two bodies. Currently the Pensions Ombudsman has the power to make the same orders as a court while decisions of FOS are not binding.”

Addleshaw Goddard: “We agree that the concerns of these organisations are completely different. We have no experience of their being any confusion or difficulty in the operation of these separate functions.”

Trade Union Congress: “While the responsibilities of the FOS go wider than the functions of the FSA, the PO’s responsibilities closely mirror those of the Pensions Regulator. If the review concludes that the FSA and TPR should remain as separate organisations, then it makes sense to keep separate ombudsman functions. There do not seem to be any great difficulties caused by the current arrangements.”

- other stakeholders - including the Council on Tribunals and the National Consumer Council - do feel there may be merit in bringing the bodies together in a more integrated way

National Consumer Council: “We support the view of the Financial Ombudsman Service (FOS) in its consultation response that there is a good case to merge the pension functions of the FOS and Pensions Ombudsman (PO) into a bespoke pensions jurisdiction within FOS.”

Council on Tribunals: “The nearest to a good case for possible merger lies in the ombudsman area, where FOS has a justifiably high reputation for effectiveness and cost efficiency and where the two roles are broadly similar. Whilst it is assumed that any merger could be achieved administratively, it may be desirable to effect this through legislation.”

Jardine Lloyd Thompson Associates: “We feel FOS and PO could be usefully merged, with a probable alignment of their statutory (and pragmatic) duties.”

The three key issues

12. My review has identified the following three key issues in relation to the current PO and FOS framework that I think need to be considered in weighing up proposals for change, along with those factors I outlined in my March consultation paper:

- small scale of PO resources – capacity for greater flexibility over the use and direction of resource would undoubtedly help to improve workflow and productivity
- complexity of PO and PPFO legislation – the current legislative framework governing the operation of the PO seems less flexible than that of the FOS, with a consequent impact on effective case management
- desirability of reducing the number of separate pensions bodies where possible – the functions seem sufficiently similar for them to be combined successfully in line with the Hampton Principles

Proposition

13. The arguments for bringing the PO and the FOS closer together and for making no change to the current arrangements were outlined in my March consultation paper. On further analysis, I do not believe that retaining the two separate bodies in their present form would provide the optimal outcome for the most effective and efficient management of pensions complaints and disputes. Some of the key arguments can be summarised as follows:

- the small scale of the PO's office can lead to considerable difficulty in managing the incoming flow of work – this can also prove a limitation in bringing down the number of investigations in progress
- the current separation of the two bodies seems to be historical, not essential – the separation seems to have continued, at least to some extent, on the basis that the FOS's remit focused primarily on those firms authorised by the FSA together with certain other financial services²
- although there is no corresponding recommendation to combine regulators, an ombudsman is independent of a regulatory body, not part of the same structure, and within a combined Ombudsman service I envisage that there would remain a separate, free standing jurisdiction for pensions – this

² The FOS's remit, established under the Financial Services and Markets Act 2000, extends beyond those firms authorised by the FSA to encompass a separate voluntary jurisdiction (in which National Savings and Investments participates) and since April 2007, a Consumer Credit jurisdiction.

would fit with the structure of the FOS, and would parallel the arrangement of TPRT as a constituent of the Tribunals Service.

14. Integrating the functions of the PO and the FOS would enable greater flexibility over the use and direction of resource in managing the flow of work. I anticipate that this would enable some cost savings from sharing resources to be realised. It would also provide an opportunity to carefully consider the PO's constitution and the DWP regulations that govern its operation in order to identify what can be done to simplify the current arrangements.

The PO constitution

15. There are some marked differences in the current statutory arrangements for the PO and the FOS which deserve careful consideration. The key areas are described in Box 1. It is important that these aspects are worked through systematically in order to determine whether they should be harmonised or whether there is a good rationale for preserving them. I have not examined these issues in detail, but they merit close attention.
16. While important, these areas do not seem to represent fundamental obstacles to integrating the two bodies. However, without careful and thorough consideration they could hamper the development and successful operation of a single, coherent body. This could undermine potential benefits. I recommend that at an early stage the Department for Work and Pensions lead a thorough examination of the PO constitution, the way in which complaints are made and determinations given, alongside integration of the two bodies, to determine what aspects of the current framework can be simplified. This would ease the transition to a single unified Ombudsman service for pensions.

Box 1

The Pensions Ombudsman: key areas that require careful consideration

- **Governance** – DWP Secretary of State appoints the Pensions Ombudsman: the scope and procedures of the PO are set out in the Pension Schemes Act 1993 and regulations all of which are the responsibility of DWP. The PO is subject to the jurisdiction of the Council on Tribunals, and complaints on the PO's process may be taken to the Parliamentary Commissioner for Administration. FOS is governed by the Financial Services and Markets Act 2000 and various rules made by the FSA and FOS. This might need alignment of the governance rules with those of the FOS, so far as this is possible, with careful consideration given to any possible future role of DWP, to ensure arrangements are streamlined and effective.

Continued

- **Funding** - The PO is funded by DWP grant in aid, with pension schemes subject to a levy collected by TPR. Consideration would need to be given as to how the integration of the PO with the FOS would impact on these arrangements and more generally on the related issue of governance of funding.
- **Determinations** - There are some differences in the nature of PO and FOS determinations:
 - The PO deals with complaints of maladministration and resolves disputes of fact or law referred by either individual members or potential beneficiaries of pension schemes or by trustees, managers, employers or administrators of pension schemes. Respondents may include trustees, managers (including employers) and administrators of pension schemes. Determinations are binding on the person making the complaint and any person responsible for the management of the scheme. The PO may direct any such person to take or refrain from taking such steps as he specifies. This can include a requirement for a compensatory award. There is no limit as to the amount of such an award or on the kind of direction which may be made.
 - The FOS deals with complaints relating to an act or omission of a body subject to its jurisdiction (where the body's activity is also covered by the FOS jurisdiction). The FOS can make compensatory awards as well as direct that certain steps be taken. A limit of £100,000 currently applies to awards of compensation. FOS determines complaints on the basis of what is fair and reasonable in the circumstances of the case: this includes taking into account relevant legislation and codes of practice.
- **External Appeal** - PO determinations are final and binding on the complainant and respondent(s), and are subject to external appeal to the High Court on a point of law. FOS determinations are binding on the body complained of and, if accepted, also on the complainant: these can be judicially reviewed.

The Pension Protection Fund Ombudsman (PPFO)

17. As part of my review I have also examined the functions of the PPF Ombudsman. The PPFO, which was established by the Pensions Act 2004 and who is also appointed by the Secretary of State for Work and Pensions, is responsible for:
- investigating PPF reviewable matters and complaints of maladministration by the Board of the PPF
 - hearing appeals against Financial Assistance Scheme decisions

18. The PO and PPFO appointments are currently both held by the same person. A joint appointment is not required in statute, but is a practical arrangement. My March consultation paper asked for stakeholder input on whether there is any reason why PPF (and FAS) cases could not also move to a combined jurisdiction, if this were considered appropriate.
19. The evidence to my review has not raised any reason as to why cases relating to PPF and FAS could not be handled within a combined arrangement.

Integrating the PO and the FOS

20. I have considered two ways in which the functions of the PO and the FOS could be integrated. These are described below. Both assume that where appropriate PO staff resource would be transferred to the FOS: this is important as it would retain expertise and enable transfer of knowledge, while allowing the FOS to develop capacity to handle complex pensions complaints.

Partial combination

21. With partial combination, the PO would continue, with the current attendant legislation, but the functions of the PO and the FOS would be co-located and use shared Finance, IT, HR, Communications resource, Media and other support services.
 - Some cost savings would be achieved.
 - Without underpinning legislative change and harmonization of case management procedures the potential benefits of full integration would not be realised.

Full integration

22. With full integration, a new jurisdiction would be created within the FOS to manage those pensions cases currently dealt with by the PO. There would need to be a separate jurisdiction and the office of the PO appointed by the Secretary of State would cease to exist – this would require changes to legislation. The precise scope of the new jurisdiction, how it was led at ombudsman level, and its relationship to the current FOS pensions function, would need to be carefully considered.
 - PO staff resource would be co-located as with the partial integration model – this may produce higher cost savings.
 - The FOS case management systems would be adopted, and appropriately skilled resources from elsewhere in FOS could be drawn on when needed to assist with meeting demand for resolution of complex pension cases, thereby increasing effectiveness.

Conclusion

23. In principle there seem to be significant disadvantages to a partial integration, including:

- limited benefits in terms of increased resource to manage pensions complaints within a large scale organisation and potential cost savings would not be fully realised
- lack of clarity and accountability for sponsoring departments on use of resource
- no obvious improvement in transparency or coherence for consumers or other stakeholders

24. It could be seen as a halfway stage prior to full integration, but in practice this would create unhelpful uncertainty over the intervening period.

25. On careful consideration of the evidence, my view is that the PO should be fully integrated with the FOS. The advantages of full integration, which are in line with Hampton Principles, are clear:

- **Improved workflow and case management** – those cases currently handled by the PO would benefit from the FOS’s good track record of managing different types of activity, with the resource that a large organisation can bring to manage volatility in demand for the service
- **Clarity and customer focus** – a single, unified scheme for handling all pensions cases, both sale and marketing of personal pensions and administration of personal and occupational schemes, would make the system more coherent and avoid need for redirection, or an MOU between the bodies, however effective
- **Costs**– although not the main driver, bringing the two bodies together would enable cost savings from sharing resources to be realised

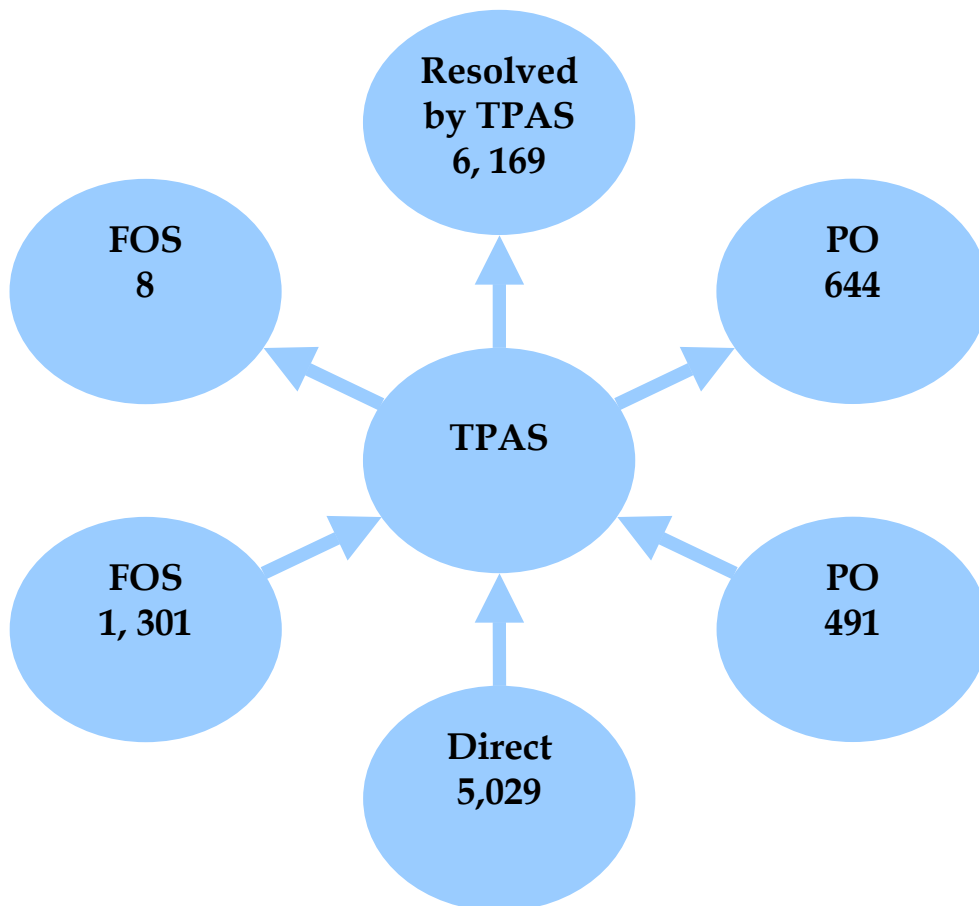
The impact on TPAS

26. TPAS provides a highly cost effective enquiry and mediation service, which has enabled the PO to deal primarily with cases requiring Ombudsman adjudication. During my consultation, TPAS has received very strong support from stakeholders. It would be vital to ensure that it can continue to provide this role in a combined structure. To recreate these resources elsewhere without retaining the same volunteer resources would be costly and problematical. I have discussed this with the Chief Ombudsman of the FOS, and he envisages that TPAS’s role should be continued.

27. Fig 2 illustrates the flow of complaint cases between TPAS, FOS and the PO. (Figures are based on TPAS records 2006/07).

28. In a fully integrated model, consideration should be given to formalising TPAS's role in dealing with enquiries and mediation which it would do in parallel with the enquiry and mediation process in the FOS. This might best be done through TPAS and FOS developing a joint Memorandum of Understanding. There may be advantages in co-locating TPAS with a fully integrated PO/FOS, although this is not essential. TPAS seem likely to see an increase in workload with the introduction of Personal Accounts, and may also be able to play a wider role in the context of the FOS's wider scope of activities.

Fig.2



Figures are based on TPAS records 2006/07

Recommendations

29. The evidence presented to me suggests that the functions of the PO should be brought within the FOS to provide a single, unified Ombudsman scheme for pensions complaints and other financial services. I recommend:

- **combining the functions of the PO and the FOS to create a single, free standing pensions jurisdiction within the FOS to manage those pensions cases currently dealt with by the PO.** There would cease to be a separate PO. The precise scope of the new jurisdiction, and its relationship to the current FOS pensions function, would need to be carefully considered. This will produce improvements in workflow and management of pensions complaints, with the advantages that a large organisation brings in terms of resource, flexibility and economies.
- **a careful analysis of the PO constitution is undertaken through a DWP led working group to fully identify what can be done to simplify the PO and improve its effectiveness.** This will assist smooth integration of the two institutions, but should be carried out in any case.
- **that in making these changes the role of TPAS is allowed for in the revised arrangements, so that it can continue to provide its present enquiry and mediation service.** This might best be done through TPAS and FOS developing a joint Memorandum of Understanding.

30. **Currently the PO has a role in providing feedback and raising issues with relevant institutions, including DWP and TPR, based on his office's casework.** This provides an opportunity to disseminate lessons learned, which assists with development of pensions policy, including regulation. FOS has a similar role in relation to the FSA. TPAS also has a role. Arrangements would need to be put in place to ensure that this continues for pensions cases.

31. **I suggest, for consideration, that a joint Steering Group is set up to oversee the processes,** with involvement of DWP, HMT, FSA and TPR as well as PO and FOS.

32. The process for the transition to a single scheme will require careful planning and management. Box 1 identifies the key areas which require closer analysis. It is important that they are worked through systematically to establish a coherent structure to assist with the integration of the two bodies, and that sufficient time is allowed for all the issues to be considered.

Section 4: The Pensions Advisory Service

Introduction

1. This section of the report considers the role of the Pensions Advisory Service (TPAS). Evidence received during my consultation shows very strong support from stakeholders: TPAS provides a highly cost effective enquiry and mediation service, which has enabled the PO to deal primarily with cases requiring Ombudsman adjudication.
2. The evidence I have received suggests that TPAS provides a low cost service through its staffing of 500 unpaid volunteers, in addition to its paid staff, handling substantial volumes of queries and resolving pensions disputes referred to it quickly and effectively.

The current structure

3. TPAS provides free of charge to members of the public a one-stop pensions information, advice and complaint resolution service. The service is delivered through a national network of some 500 volunteer pensions professionals supplemented by a small paid staff (based in London).
4. In the year 2006/07, TPAS dealt with 6800 complaints, of which it resolved 90%. Of the 10% who chose to take their complaint further, the vast majority went on to the PO while a much smaller number apply to the FOS and a handful turn to TPR. TPAS has indicated to me that the evidence from the current year suggests that their complaint work has increased due to a greater awareness of its service.
5. My firm view is that the current structure of TPAS works effectively and efficiently. I have seen no evidence that the current structure should be altered. TPAS is predominantly a voluntary organisation: there is great social and financial value in this and it gives the body a unique place in the pensions landscape in the UK.

Stakeholder input to the Review

6. The response from stakeholders to my consultation has demonstrated strong support for the service TPAS provides - some of the responses I have received are presented below:

Age Concern England: “Age Concern values the work of The Pensions Advisory Service both in its role of helping with complaints and provision of specialist pension information and generic advice. It is extremely useful for us to be able to draw on their expertise and our staff and volunteers working at a national level and in local Age Concerns find it very useful to be able to refer people to TPAS. With ongoing pensions reform and the introduction of personal accounts in 2012 the need for such a service will increase...”

British Telecom Pension Scheme: “TPAS is a well established, well-regarded organisation that provides a highly professional and relatively speedy service at a very low unit cost. It would be to the advantage of scheme members and everyone involved in pensions if maximum use was made of the expertise of advice available through TPAS.”

Association of Consulting Actuaries: “We believe that the Pensions Advisory Service plays a unique role in the UK pensions system. All the other bodies under review provide regulation or member protection. TPAS is the only body that actually provides advice directly to members.”

Occupational Pensioners’ Alliance: “TPAS plays an important and understood mediation and information role and should remain independent of the regulatory bodies.”

Impact of combining the PO/ FOS

7. In the previous section I recommended that the functions of the PO and the FOS should be combined and that the role of TPAS should be allowed for in the revised arrangements, so that it can continue to provide its present enquiry and mediation service.

Wider changes

8. A number of wider changes are likely to have significance for TPAS.
 - Otto Thoresen is undertaking an independent Review into delivering a national approach to generic financial advice. TPAS may have a role to play in this through its information and generic financial advice service covering the field of pensions
 - Personal Accounts – there may be a role for TPAS in providing advice for individuals on the introduction and running of the Personal Accounts
9. Although these aspects fall outside the scope and timeframe of my review, I commend TPAS to those involved in formulating policy in these areas.

Section 5: TPRT and the FSCS

Introduction

1. My discussions and the written evidence from the institutions and their stakeholders have confirmed the tentative conclusions I expressed in the consultation paper about both the Pensions Regulator Tribunal and the Financial Services Compensation Scheme.
2. The response from stakeholders to my consultation has demonstrated that no changes to the current boundaries are necessary - some of the responses I have received are presented below:

Stakeholder input Comments on FSCS

Friends Provident: "We are in agreement that there appears to be no need to revise the functions and boundaries of the Financial Services Compensation Scheme".

Institute of Chartered Accounts for England and Wales: "We do not believe that any changes are needed."

National Association of Pension Funds: "We do not think any changes are required to the functions or boundaries of the FSCS."

Society of Pensions Consultants: "We have not identified any need for changes to functions or boundaries in this area."

Stakeholder input Comments on TPRT

Association of Consulting Actuaries: "As with many other of the bodies discussed here, we believe it is too soon to review the role and responsibilities of the Pensions Regulator Tribunal."

National Association of Pension Funds: "We do not think any changes to the functions or boundaries of the Pensions Regulator Tribunal are needed. Should any changes to the boundaries of TPR arise as a result of this review these will need to be reflected in the functions and boundaries of the Pensions Regulator Tribunal."

3. I have concluded that role of the FSCS is clear and self-contained, and I see no need to revise its functions and boundaries.
4. I have also concluded that the role of TPRT is clear and specific, and I see no need to revise its functions and boundaries.

Chapter 4: Summary of recommendations

The PPF and TPR

I have concluded that the best way forward is to adopt a package to institutionalise co-operation and ensure even closer and more effective working between the two organisations. This package would provide useful tools for underpinning the current excellent level of co-operation, whilst avoiding the downsides of major reorganisation: churn in the institutions, a substantial package of legislation, and uncertainty in the wider pensions world.

- Appointment of an additional, shared, non-executive member to both PPF and TPR Boards.
- Standing invitation for attendance of the Chief Executive of TPR/PPF to attend the Board meetings of the other body.
- Establishment of a formal Pensions Institutions Forum – to include TPR, PPF, TPAS, PO, PPFO, DWP and HMT, with FSA and FOS in their pensions capacity.
- Publication of a joint policy statement of the principles associated with data collection and sharing, and with information gathering.
- Publication of a joint statement of the respective roles and responsibilities of PPF and TPR in those cases where PPF is also involved in clearance applications made to TPR.

Alongside the above recommendations there are further operational arrangements that could be usefully adopted to further streamline the two institutions:

- Holding an annual strategy day involving both Boards.
- Encouraging the ongoing regular interchange/ secondments of senior and other staff between TPR, PPF and DWP, and the private sector.

TPR and FSA

I recommend a further package of proposals, which would provide useful tools for building on the arrangements that the two bodies have put in place, in order to maximise co-ordination over the regulation of DC schemes, together with clarity for the regulated community.

- Establishment of the formal Pensions Institutions Forum – as above.

- Combined information, including development of an electronic tool kit which covers those aspects of DC regulation for which the two institutions are responsible.
- Combined communications/ consultation/ surveys.
- Enhancement of the current arrangements for consumer and practitioner input in the areas of mutual interest.

It would be important for TPR and FSA to seek feedback from stakeholders about implementing proposals on these lines.

PO/ PPFO and FOS

The evidence presented to me suggests that the functions of the PO should be brought within the FOS to provide a single, unified Ombudsman scheme for pensions complaints and other financial services. I recommend:

- Combination of the functions of the PO and the FOS to create a single, free standing pensions jurisdiction within the FOS to manage those pensions cases currently dealt with by the PO.
- PPFO cases could also be dealt with under the new pensions jurisdiction.
- Careful analysis of the PO constitution to be undertaken through a DWP led working group to fully identify what can be done to simplify the PO jurisdiction and improve its effectiveness.
- Creation of a joint Steering Group to oversee the combination processes, with involvement of DWP, HMT, FSA and TPR as well as PO and FOS.
- The revised arrangements to allow for the role of TPAS, so that it can continue to provide its present enquiry and mediation service.

TPAS

I commend TPAS to those involved in formulating policy on Personal Accounts and on generic financial advice, about which decisions will be taken in future months.

FSCS

I recommend no change to the functions and boundaries of the FSCS.

TPRT

I recommend no change to the functions and boundaries of TPRT.

Annex A - Review of Pensions Institutions: terms of reference

- To review how the functions of the organisations set up by the 2004 Pensions Act - The Pensions Regulator and the Pension Protection Fund - fit with the Government's existing pensions policies, its pension reform proposals, and wider developments in the pensions market.
- To consider also how other organisations with responsibilities for the regulation and protection of workplace pensions interact with them on work based pensions issues.
- To make recommendations about the most appropriate future configuration of organisational responsibilities, providing robust governance and the most effective, efficient and affordable arrangement of functions, avoiding duplication and conflicts of interest, in order to deliver Government policy.

Methodology

- To examine how the functions of the organisations established through the Pensions Act 2004 – the Pension Protection Fund (PPF) and the Pensions Regulator – fit with the Government's pension reform proposals.
- To examine how the functions of further bodies also fit with the reform proposals. This extends to those involved in:
 - Regulation of work-based pensions, particularly the FSA;
 - Provision of advice, mediation, dispute resolution or compensation for pensions, in particular the Pensions Advisory Service, Pensions Ombudsman, the PPF Ombudsman, Financial Ombudsman Service (in a pensions role), Pensions Regulator Tribunal, and the Financial Services Compensation Scheme (in a pensions role).
- To consider any implications for the coherence of the regulatory structure applied across the pensions market, taking account of the Hampton principles.
- To take account of possible future regulatory developments, including those from Europe and beyond.
- The review will not need to examine the administration arrangements for the Financial Assistance Scheme, as these have been separately examined, with decisions announced in July 2006.

- To encourage debate and aim to build consensus, consulting on emerging proposals for any changes in the way the functions are best configured between organisations.
- To complete the review, reporting with reasoned recommendations to Ministers by Spring 2007.

Annex B - Description of Pensions Institutions under review

This annex describes the status, statutory objectives, staffing and funding of those institutions covered by the Review's terms of reference.

Regulation

The Pensions Regulator (TPR)

The regulatory body for work-based pension schemes, established under the Pensions Act 2004, which takes a risk-focused approach to regulation. It commenced operations from 6 April 2005, replacing the Occupational Pensions Regulatory Authority (Opra). It is an executive non-departmental public body, accountable to the Secretary of State for Work and Pensions and funded by a levy on each registrable occupational and personal pension scheme. It employs around 250 permanent and fixed term staff, plus around 70 secondees and contract staff.

The Regulator has four statutory objectives:

- to protect the benefits of members of occupational pension schemes;
- to protect the benefits of members of work-based pension schemes;
- to reduce the risk of situations arising that may lead to claims for compensation from the Pension Protection Fund; and
- to promote good administration of work-based pension schemes

The Financial Services Authority (FSA)

The Financial Services Authority (FSA) is an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. It is a company limited by guarantee. The FSA is accountable to Treasury Ministers, those it regulates and Parliament. It regulates the financial services industry in the UK and is funded entirely by the firms it regulates. It employs around 2,600 staff.

The FSA has four statutory objectives:

- to maintain market confidence;
- to provide the appropriate degree of consumer protection;
- to promote public understanding of the financial system – this extends to all forms of pension provision ; and
- to reduce financial crime.

The FSA's pensions role

The FSA's pensions role involves -

- regulating the sales and marketing of personal pensions (including stakeholder pensions) and annuities; this includes the suitability of advice, pre-sale disclosure and firms' financial promotions.
- from April 2007, regulating the establishment, running and winding up of all personal pension schemes, including self-invested personal pension schemes (SIPPs).

- the prudential regulation of firms who provide personal pensions, stakeholder pensions and annuities;
- the authorisation and prudential regulation of fund managers who manage pension fund assets; and
- a statutory responsibility to promote public awareness of the financial system, which extends to all forms of pension provision.

Advice, mediation, dispute resolution

The Pensions Advisory Service (TPAS)

An independent, non-profit organisation providing free information, advice and guidance on state pensions and work-based, personal and stakeholder pension schemes. TPAS, which was formed in 1983 initially as a charity, (and previously called the Occupational Pensions Advisory Service,) is a non-departmental public body sponsored by the Department for Work and Pensions. Its services are provided free of charge. It employs around 35 paid staff and 480 volunteer advisers.

As well as giving generic advice and targeted information on pensions, its work involves running:

- a dispute resolution service for private pension scheme members through a national network of pensions professionals acting in a voluntary role;
- a public enquiry service for pensions queries through its helpline.

The Pensions Ombudsman/ The Pension Protection Fund Ombudsman (PO/ PPFO)

An independent and impartial adjudicator created by The Social Security Act 1990 and the Pensions Act 2004 respectively. The Ombudsman is an independent commissioner appointed by the Secretary of State for Work and Pensions and funded by levy on pension schemes. The Ombudsman's determinations are final and binding on all parties, subject only to appeal in the High Court on a point of law. It employs around 45 staff.

The Ombudsman is responsible for:

- investigating and determining complaints of injustice caused by maladministration and disputes of fact or law in relation to decisions made on occupational and personal pension schemes
- investigating PPF reviewable matters and complaints of maladministration by the Board of the PPF;
- hearing appeals against Financial Assistance Scheme decisions.

The Financial Ombudsman Service (FOS)

An independent body, created by the Financial Services and Markets Act 2000, which became operational on 1 December 2001. The FOS is a public financial institution responsible for resolving individual disputes between consumers and financial services firms quickly and informally. Ombudsman decisions are not binding on consumers unless they choose to accept them; decisions are binding on firms. FOS is funded by a levy on financial services companies within its jurisdiction and from case fees, which become payable when chargeable cases are closed. Consumers do not pay to bring a complaint to the FOS. It employs around 950 staff.

FOS's jurisdiction covers

- all retail financial services firms authorised by the FSA;
- those businesses who have voluntarily agreed to be covered by the FOS, such as National Savings & Investments.
- since April 2007, all businesses that have a standard consumer credit licence from the Office of Fair Trading (OFT).

The Pensions Regulator Tribunal (TPRT)

An independent body established under the Pensions Act 2004. It is responsible for hearing appeals on determinations made by the Pensions Regulator, and forms part of the Tribunals Service. The Pensions Regulator is bound by the direction of the Tribunal. It is funded with monies provided by Parliament, as the Lord Chancellor may determine. It employs 3 part time staff.

The Tribunal's functions involve deciding whether to:

- confirm the determination and any order, notice or direction it made;
- vary or revoke the determination and any order, notice or direction it made; or
- substitute a different determination, order, notice or direction.

Compensation

The Pension Protection Fund (PPF)

The Board of the Pension Protection Fund was established by the Pensions Act 2004. It is a public corporation, which became operational on 6 April 2005 and is accountable to the Secretary of State for Work and Pensions. It is funded by a levy on eligible schemes and by taking in the assets of schemes entering the PPF. It employs around 130 staff.

The PPF has two statutory functions: to hold, manage and apply the funds known as the Pension Protection Fund and the Fraud Compensation Fund. PPF roles include:

- to pay compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer, and where there are insufficient assets in the pension scheme to cover the PPF level of compensation;
- to charge compulsory annual levies on all schemes eligible for the PPF;

- to invest the assets of the PPF; and
- since September 2005, to manage the Fraud Compensation Fund – to provide compensation to occupational pension schemes that suffer a loss that can be attributable to dishonesty.

The Financial Services Compensation Scheme (FSCS)

The UK's statutory fund of last resort for customers of financial services firms authorised by the FSA. The FSCS, established by the Financial Services and Markets Act 2000, and operational on 1 December 2001, is an independent body, which can pay compensation if a firm is unable, or likely to be unable, to pay claims against it. FSCS is funded by levies on firms authorised by the FSA. It employs around 200 staff.

The FSCS statutory functions are to protect:

- deposits,
- insurance policies,
- investment business,
- insurance broking (for business on or after 14 January 2005), and
- mortgage advice and arranging (for business on or after 31 October 2004).

Annex C - Initial questions (January - 9 February)

The initial consultation questions (January - 9 February) that I posed on the Review web pages, on the day I was appointed (16 January), for response by 9 February were:

- How you consider each of the institutions under review is currently functioning in its work-based pensions roles, which include regulation, protection, provision of advice, mediation, dispute resolution and compensation?
 - What are the shortcomings, if any, in the present arrangements, including gaps, overlap, duplication, inappropriate conflict of interest or inefficiencies? What are the strengths of the present arrangements?
 - How you consider the interactions are working between the institutions.
 - Is there evidence to demonstrate that the current arrangements on the regulation of work-based pensions and provision of advice, mediation, dispute resolution or compensation work well or do not work well?
- Is there evidence of effective joint working, clear distinction of responsibilities and evidence of possible conflict of interest?
 - Is there evidence to suggest that the current boundaries of responsibilities and number of organisations are confusing to customers?
- What suggestions do you have, taking into account of the Hampton principles, to improve the configuration of functions and responsibilities to best deliver effective regulation and protection of work-based pensions, with robust governance, in an effective efficient and affordable way, and most effectively to meet the Government's pensions objectives, encouraging people to save in work-based pensions?
- What further regulatory developments are key to the configuration of institutional functions, including those from Europe and beyond?

Annex D - Consultation questions and key arguments put to me prior to consultation

Following initial discussions with each of the institutions under review and responses to my initial January call for evidence, I presented the following key issues for particular consideration in my 7 March consultation paper:

- Is there a good case for bringing the PPF and TPR closer together?
- Is there a good case for bringing FSA and TPR closer together?
- Is there a good case for bringing the PO and the FOS closer together?

I also sought input on several further issues:

- Are any changes to PPF Ombudsman functions or boundaries needed?
- Are any changes to TPAS functions or boundaries needed?
- Are any changes to FSCS functions or boundaries needed?
- Are any changes to TPRT functions or boundaries needed?
- How are pension reforms likely to impact on TPR?
- Are the factors identified the key ones for weighing up proposals for change?

In the consultation paper I also set out the key arguments that had been put to me in favour of bringing the bodies together, and in favour of making no change:

Is there a good case for bringing the PPF and TPR closer together?

The key arguments that have been put to me in favour of bringing the two organisations closer together are:

- A single organisation for those affected by pension regulation and compensation would make for simplicity and better accountability, enabling better communications with users about the approach to regulation and compensation, and on the size and distribution of the risk-based levy in relation to overall objectives for scheme funding.

- A single organisation would enable all the risks to pension schemes and their members to be considered, rather than specific consideration of risk to the compensation fund. Having a single body would enable it to take a comprehensive approach to risk assessment, in line with Hampton principles.
- A single organisation would enable clearer responsibility for managing the trade-offs between objectives. Currently entry of pension schemes to the PPF has relatively few consequences for TPR: it is the PPF which makes the payments and raises the levy to finance them. A single organisation would itself have to raise the levy to finance the cost of the schemes which enter the compensation fund. It would therefore have more immediate incentives to consider any alternative to this option. In particular, a combined body would be better able to make the necessary judgements in clearance cases and in setting the risk-related PPF levy, balancing its objectives to both protect members benefits and to protect the PPF.
- TPR's statutory objective to protect the PPF involves many interactions between the two bodies particularly on funding of DB schemes and clearance of corporate transactions.
- Functions are closely related, with overlaps and potential synergies:
 - TPR's policy on funding and clearance influences the risks posed by schemes to the PPF.
 - Close working between TPR and PPF can be important during clearance applications – currently requiring separate negotiators from TPR and PPF at a time when pressures are intense.
 - The Pensions Act 2004 Section 179 PPF valuation basis is one of TPR's funding benchmarks.
 - The risk based levy and TPR's views of risk need to be complementary; the joint production of the Purple Book shows the shared interests of the two bodies in work on risk.
- The bodies have complementary and overlapping expertise in working with pension schemes at a micro and at a macro level.
- Roles overlap in a range of areas including analysing data, assessing risk of employer insolvency, and collecting levies.
- A single body could deliver cost savings through sharing a range of services including IT, HR, finance and media relations.

- TPR believes that a combined organisation would be better able to fulfil the Government's overall objectives.

The key arguments that have been put to me in favour of making no change to the current arrangements are:

- Both bodies are relatively new, as is the structure, set in place by the 2004 Pensions Act, to rebuild confidence in the pensions system. Starting in April 2005, both bodies have made a quick and effective start on developing key powers and functions. PPF made its first compensation payments in December 2006 and is currently collecting its first full risk based levy; TPR has issued guidance on its approach to clearance and funding. However, both organisations have further development of their functions to undertake, and there is limited substantive evidence to date on which to base any change. Early organisational change could distract both bodies from building successfully on their initial achievements, impact delivery and undermine confidence in the 2004 Act regime.
- Having separate bodies enables each to develop its own expertise and focus on its distinctive core functions. Each body has developed a distinctive skill set and culture.
- PPF's approach to risk assessment could be compromised by being part of a combined organisation with broader objectives. This seems to me to be a particularly important issue and requires close examination.
- There is potential for real and/or perceived conflicts of interest. Examples include tensions between regulator and creditor roles, and between setting the levy and determining scheme funding policy. Combination would also remove a creative tension – the challenge function inherent where one body (TPR) has a statutory duty to minimise calls on the other (PPF).
 - On the one hand separate bodies enable checks and balances to be transparent, but on the other hand a single body could be well placed to resolve issues internally.
 - There would be an acute reputational risk to a combined body with regulatory functions if it were subjected to potential insolvency risk, or needed to reduce compensation.
- There would be potential confusion over a combined body's solvency, investment and actuarial strategies. It would be important to ensure through clear communication that these did not become *de facto* norms for pension schemes.
- PPF has no regulatory functions, but has many functions of a financial institution, such as investment management, insurance and compensation

administration, with substantial accountability to the pensions industry as levy payers and to scheme members.

- Combining regulatory and financial institution functions could increase the risk of operational failure.
- The two bodies have succeeded in working together. Close co-operation including a tripartite Memorandum of Understanding, service level agreements and working relationships at a range of levels and on specific projects (for example, the Purple Book) help ensure the interfaces between TPR and PPF work well.
 - It has however required some attention by both bodies to make this work.
- Employers and pension schemes might see such a change as likely to lead to a more risk-averse, regulation-dominated protection regime.
 - TPR have however avoided a prescriptive approach to clearance and funding.
- Introduction of a new system for Personal Accounts and their regulation/compliance requirements could impact on the capacity of a combined body to take on additional work.
 - Long term resources would need to be recruited, and a PPF role would further increase TPR's span of control over functions.
- There would be transitional costs for schemes to bear via the Administration levy, and management requirements potentially coinciding with significant challenges on introduction of Personal Accounts
 - There could however be longer term savings, and the changes could take effect from an earlier date than introduction of Personal Accounts.
- There is no agreed basis for change – PPF regard a merger as inappropriate and disruptive at a critical time for building confidence in pensions.

Is there a good case for bringing FSA and TPR closer together?

The key arguments that have been put to me in favour of bringing the two organisations closer together are:

- In principle, it may well be logical to make changes, since the boundaries between occupational pensions and other financial savings products are becoming more blurred and more complex over time due to changes in the market.
- The current boundary is complex. It is not however feasible to achieve a simple boundary, even by making changes to it, and hence to provide clarity for consumers.
 - Even if all pensions regulation were combined, there would still be the need to distinguish between different aspects.
- TPR has recently consulted on DC risk, the investment components of which are an example of an area within scope for both TPR and FSA, and where a consistent approach is needed and not currently easy to achieve.
- There appears to be a gap in coverage of regulation and supervision of Independent Financial Advisers advising employers on a transfer between one occupational scheme and another. This is also affecting redress for individual complaints because the Pensions Ombudsman and the Financial Ombudsman Service have no jurisdiction in these cases.
- The trend from DB towards DC schemes and to annuity buy-out may bring a larger proportion of pension liabilities under FSA supervision, although that transition is likely to take a period of many years.
 - However, if that is the trend, it might be appropriate to make regulatory changes sooner rather than later.
- There could be cost savings through sharing a range of services including IT, HR, finance and media relations.

The key arguments that have been put to me in favour of making no change to the current arrangements are:

- The arrangement of functions seems to work well in practice. The delineation of boundaries is proving workable and is flexible. The boundaries seem to be understood by TPR and FSA, with, for example, an effective Memorandum of Understanding in place.
- There does not seem to be evidence from any of the pension bodies of consumer confusion to suggest a change is needed.
- Pensions and financial services are substantially different from each other in the UK in their regulatory context, and require a different style of regulation. Though pensions are financial services, it remains sensible to continue currently to regulate them separately. This reflects occupational pension provision being intimately linked to social policy, and the fact that employer-provided pension funds are not comparable with other financial institutions. The employer covenant stands in place of solvency capital; historically pension provision has been a voluntary act by employers.
- It does not seem appropriate to follow other countries where pension fund and insurance supervision is under a shared umbrella, as their pension arrangements typically have a different legal constitution and history.
- If insurance and pension products were under the same regulator there would be more difficulty in withstanding international pressure to adopt the same solvency requirements for both.
 - Solvency requirements are currently evolving with work in development of the Solvency II Directive, and the implications for pension provision are likely to be considered over the next few years.
 - However the particular regulatory structures in place will not in themselves dictate whether or not similar solvency requirements are applied to pensions as to insurance products under European legislation.
 - FSA and TPR regulate differing communities. (For example TPR has close links with employers, unlike the FSA).
 - Both FSA and TPR have let me know they have currently no appetite for change.

Is there a good case for bringing the PO and the FOS closer together?

The key arguments that have been put to me in favour of bringing the two organisations closer together are:

- The separation may be a historical rather than an essential one, particularly given that FOS has a remit which extends beyond FSA functions, including its voluntary jurisdiction (in which National Savings and Investments participates) and its forthcoming Consumer Credit jurisdiction (from April 2007).
- I have heard that the FOS has a track record of managing different types of activity, for example it has low unit costs, good case throughput rate, and has successfully expanded its remit. It had originally replaced eight separate complaint handling bodies. It has subsequently taken over the work of three others. I also understand that its pensions cases may be among the most complex it handles. I have heard that the smaller scale of the PO's office can prove a limitation in bringing down the number of investigations in progress, and its workload is not easy to predict. FOS's workload is also not easy to predict but, subject to further analysis, a combination might provide the efficiencies and economies of scale currently unavailable in the PO's office.
- I have heard that there is a need for some redirection of cases between the two Ombudsmen, albeit an effective process seems to exist to pass cases to the correct body. Combination might reduce consumer confusion over which Ombudsman handles which pensions cases, and all investigatory work could be handled by one body. (Both Ombudsmen refer a significant number of cases to TPAS.)
- Involvement of the DWP in the FSA's process for appointment of the lead pensions Ombudsman could enhance the independence of the PO within a combined organisation.
- There could be cost savings through sharing a range of services including IT, HR, finance and media relations.

The key arguments that have been put to me in favour of making no change to the current arrangements are:

- If there remains one regulator for financial services and another for occupational pensions, it is also appropriate to have separate Ombudsman services.
- The Memorandum of Understanding between the PO and the FOS appears to be working well; it shows a clear distinction of responsibilities between the two offices and avoidance of possible conflicts of interest.
- Additions to the FOS's workload could be to the detriment of focus on its 'core' financial services work.
- FOS currently does not have the in-depth knowledge of pensions held within the PO's office.
 - However there are various ways this could be addressed.
- The provisions are different as to subsequent routes of appeal, and the extent to which determinations are binding, reflecting the distinctive nature of pensions work.
 - However, these could be preserved, or harmonised as considered appropriate, and this could be the subject of more detailed consideration.
- There could be a need for revised governance arrangements.
- A combination could alter the role played by TPAS in mediation of pensions cases, as FOS provides a mediation service of its own.

Annex E - Contributors to the review

I am grateful for the invaluable contributions received from the institutions which formed the basis for my Review:

Financial Ombudsman Service
Financial Services Authority
Financial Services Compensation Scheme
The Pensions Regulator
The Pensions Regulator Tribunal
The Pensions Advisory Service
Pension Protection Fund
Pensions Ombudsman
Pension Protection Fund Ombudsman

I am also grateful to the following organisations and individuals that contributed to the Review:

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Barnett Waddingham LLP
BT Pension Scheme
Committee of European Insurance and Occupational Pensions Supervisors
Confederation of British Industry
Council on Tribunals
Pete Davis
Electricity Pensions Services Limited
Engineering Employers Federation
Entegria
Faculty and Institute of Actuaries
Financial Reporting Council
Friends Provident Life and Pensions Ltd
Independent Trustee Services Ltd
Institute of Chartered Accountants in England and Wales
International Business Machines UK Pension Scheme
International Organisation of Pension Supervisors
Investment Management Association
Jardine Lloyd Thompson Associates
Con Keating

Legal and General
Morgan Stanley
National Association of Pension Funds
National Consumer Council
Occupational Pensioners' Alliance
Paternoster
Pensions Management Institute
Pensions Policy Institute
Pensions Research Accountants Group
PFP Group
Prudential
Society of Pension Consultants
Standard Life
Jeremy Stone
Trades Union Congress
Watson Wyatt

Annex F - Suggested role of a formal Pensions Institutions Forum

The Forum would be a new body, chaired by a senior independent person, meeting perhaps once or twice a year, to give impetus to sharing good practice and developing effective co-ordination, and to view the impact of pensions reform and other developments holistically.

Key bodies to include would be TPR, PPF, TPAS, PO/PPFO, DWP and HMT, with FSA and FOS in their pensions capacity. FAS might usefully be added.

The body would be a forum for discussion of key current and emerging issues which have relevance for a number of bodies and would provide a top level forum in which each body's experience can inform the others. It could explore synergies and share good practice and emerging issues between institutions involved in workplace pensions.

The Forum would not be a decision-making body, nor one which would scrutinise legislative proposals, or be required formally to be consulted for approval. The Forum would not need to have a legislative basis.

The Forum would build on and strengthen the current arrangements between a number of the pensions bodies to meet together as a group from time to time: the existing staff forum includes TPR, PPF, TPAS, PO, PPFO and DWP. Its role would complement the ongoing range of bipartite and tripartite arrangements, both formal and informal, established to discuss, make decisions, and take forward work on specific issues: those of particular relevance to a smaller group of the bodies.

The Forum would report to DWP and HMT Ministers, keeping them and stakeholders updated on subjects it discussed, and recommendations it made. The Chair might, for example, have a base in one of the institutions, such as a non-executive member of DWP's Pension Client Board, and might be chosen by rotation.

The Forum could, for example, host an annual stakeholder summit focussing on co-ordination across the institutions involved in workplace pensions.

Such a body could be well placed to suggest that Government might instigate a review of TPR and PPF, and the other bodies, some 5-10 years hence, by which time it should be clearer whether there are any problems attributable to separation of the functions, in the light of experience with developments in pensions reform, and of external changes in the pensions world.

Annex G - Glossary: acronyms and abbreviations

CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
DB	Defined benefits
DC	Defined contributions
FAS	Financial Assistance Scheme
FSA	Financial Services Authority
FSCS	Financial Services Compensation Scheme
FOS	Financial Ombudsman Service
Hampton review	HMT sponsored, independent Review
HMT	Her Majesty's Treasury
IOPS	International Organisation of Pension Supervisors
IORP	Institution for Occupational Retirement Provision
NDPB	Non Departmental Public Body
OPAS	Occupational Pensions Advisory Service (predecessor to TPAS)
OPRA	Occupational Pensions Regulatory Authority (predecessor to TPR)
PO	Pensions Ombudsman
PPF	Board of the Pension Protection Fund
PPFO	Pension Protection Fund Ombudsman
SIPPS	Self-invested personal pension schemes
Solvency II	European Union review of the current insurance Directives
TPAS	The Pensions Advisory Service
TPR	The Pensions Regulator
TPRT	The Pensions Regulator Tribunal
Thoresen review	HMT sponsored independent Review

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Annex I - Biographical note

Paul Thornton is Managing Director of the Pensions Advisory team at Gazelle Corporate Finance Limited, providing advice on financing pension shortfalls to pension trustees, sponsoring employers and private investors. He is an adviser to PensionDCisions, which provides an investment performance benchmarking service to sponsors and members of DC pension schemes, a non-executive director of BGI Pensions Management Ltd, and a member of the independent With Profits Committee of Prudential Assurance.

Until June 2006, Paul was a Consulting Actuary in Watson Wyatt Limited, the European arm of Watson Wyatt Worldwide. He was Senior Partner of Watson Wyatt LLP from May 2001 until July 2005. As the Senior Partner he was Chairman of the European Partnership Board, having been Chairman of the UK firm's Management Committee from 1995 to 1997, and Chairman of the Board overseeing Watson Wyatt's European operations from 1996 to 1999. He served on the Watson Wyatt Worldwide Board of Directors from November 2000 until January 2006.

Paul joined Watson Wyatt (formerly R Watson & Sons) in 1974, qualifying as a Fellow of the Institute of Actuaries in 1975 and becoming a Partner of the firm in 1977. Paul has experience of advising large pension arrangements both at a national and international level and was Scheme Actuary to the BT Pension Scheme, which is the largest private sector pension fund in the UK . He is a member of the "Committee of Wise Actuaries" appointed in connection with the Pension Reserve Fund of the European Patent Office.

He has written professional papers on Scheme Design, Bulk Transfers and Realistic Funding Assumptions as well as other pension topics, and has spoken at OECD and World Bank conferences in addition to participating in meetings of the OECD Private Pensions Working Party and the International Organisation of Pension Supervisors on behalf of the International Actuarial Association.

Paul was President of the Institute of Actuaries from July 1998 to July 2000, having been Chairman of the Pensions Board of the Faculty and Institute of Actuaries from 1994 to 1996 and Chairman of the Association of Consulting Actuaries from June 1997 until June 1998. He is currently a member of the Disciplinary Appointments Committee and of the International Committee of the UK Actuarial Profession.

Paul was Chairman of the Pensions Committee of the Groupe Consultatif of European Actuaries from October 1999 until October 2005, Chairman of the Committee of the International Actuarial Association dealing with Pensions and Employee Benefits from December 1995 until December 2005 and has been a member of the Executive Committee and Council of the International Actuarial Association.

