A transparent and effective system

Box 6.A: Summary

- The publication of public service pension scheme data is inconsistent and this hinders effective monitoring and analysis. All public service pension schemes should regularly publish data which, as far as possible, is produced to common standards and methodologies and is then collated centrally. This information should be of a quality that allows simple comparisons to be made across government, between schemes and between individual Local Government Pension Scheme (LGPS) Funds.

- Governance arrangements for public service pension schemes vary considerably. All scheme members deserve to know that their scheme is being properly run and every public service pension scheme (and individual LGPS Fund) should have a properly constituted, trained and competent Pension Board, with member nominees, responsible for meeting good standards of governance, including effective and efficient administration. There should also be a pension policy group for each scheme at national level, for considering major changes to scheme rules.

- Communication with scheme members is considered crucial in improving general pension knowledge and in promoting a sense of pension ‘ownership’. All public service pension schemes should issue regular benefit statements to active scheme members, at least annually and without being requested and promote the use of information technology (IT) for providing information to members and employers.

- Governance and the availability and transparency of information would be improved by government establishing a framework that ensures independent oversight of the governance, administration and data transparency of public service pension schemes. Government should consider which body or bodies, including for example, The Pensions Regulator, is most suitable to perform this role.

- When assessing the long term sustainability of public finances it is important that the impact of public service pensions is subjected to closer scrutiny than is currently the case. The Office for Budget Responsibility should provide a regular published analysis of the long term fiscal impact of the main public service pension schemes (including the funded LGPS).

- Managing investment funds is an additional aspect of pension scheme governance for the funded LGPS schemes. Currently the funding and investment strategies are too narrowly focused on the individual Funds rather than on the overall sustainability of the LGPS. Centrally collated comprehensive data, covering all LGPS Funds, should be published including Fund comparisons, which, for example, clarify and compare key assumptions about investment growth and differences in deficit recovery plans.
Box 6.A (continued): Summary

- Good administration is essential if pension schemes are to be run well. Many schemes seem to be, but costs vary significantly and meaningful comparisons are hampered by a lack of defined standard outputs. Government should set what good standards of administration should consist of in the public service pension schemes based on independent expert advice. The Pensions Regulator might have a role, building on its objective to promote good administration. A benchmarking exercise should then be conducted across all the schemes to help raise standards where appropriate.

- New initiatives to save costs by sharing administrative services and contracts are being trialled by a number of LGPS authorities across the UK. Central and local government should closely monitor the benefits associated with the current co-operative projects within the LGPS, with a view to encouraging the extension of this approach, if appropriate, across all local authorities. Government should also examine closely the potential for the unfunded public service schemes to realise greater efficiencies in the administration of pensions by sharing contracts and combining support services, including considering outsourcing.

- The current public service pension schemes are established under a variety of legislative arrangements. In order to provide greater transparency, simplicity and certainty, the Government should introduce primary legislation to adopt a new common UK legal framework for public service schemes.

The need for change

6.1 In its interim report\(^1\) the Commission noted that the debate around public service pensions is hampered by a lack of consensus on key facts and figures and a lack of readily available and relevant data. There are also inconsistent standards of governance across the schemes. Consequently it is difficult for scheme members, taxpayers and commentators to be confident that schemes are being effectively and efficiently run. It also makes it more difficult to compare between and within schemes and to identify and apply best practice for managing and improving schemes.

6.2 This chapter looks at the current arrangements for the overall governance, administration and financial management of public service pension schemes, including the publication of data, comparing these where appropriate with the arrangements for private sector occupational pension schemes. It recommends improvements which the Commission believes will help improve both trust and confidence in the way the schemes are managed.

6.3 The legal and regulatory framework that applies in the private sector would not be appropriate for the public service given, for example, the statutory roles of Secretaries of State and others and the effective underwriting of unfunded and funded public service schemes.

\(^1\) IPSPC (2010) Interim report, paragraph 7.2.
pension promises by the State. However, there seems no good reason why the main principles and some of the best practice of the private sector should not also be applied in the public services. The Government might also consider whether such changes should be framed by new overarching primary legislation, which would replace provisions such as the Superannuation Act 1972.

**Governance**

**Current governance arrangements for public service pension schemes**

6.4 Currently the governance arrangements for public service pension schemes vary considerably with some schemes having structures in place that are as good as benchmarked examples in the private sector, whilst others are not yet to this standard. There are various categories of governance structures at present, which can broadly be categorised as unfunded and centrally administered, unfunded and locally administered and funded and locally administered. These are described in Table 6.A.

<table>
<thead>
<tr>
<th>Unfunded centrally administered e.g. teachers, NHS, armed forces</th>
<th>Unfunded locally administered i.e. police &amp; firefighters</th>
<th>Funded locally administered i.e. LGPS</th>
</tr>
</thead>
<tbody>
<tr>
<td>The appropriate Secretary of State or Minister is legally responsible for the scheme and sets policy and rules, but delegates the day to day running to an Accounting Officer, accountable to Parliament.* Some schemes have a pension board or group.</td>
<td>The relevant Secretary of State (Home Affairs and Communities and Local Government)* is responsible for the scheme, but local police and fire authorities administer the schemes.</td>
<td>The Secretary of State for Communities and Local Government (or equivalent for Devolved Administrations)* is responsible for the scheme. Each local authority responsible for a Fund is required to appoint an officer responsible for pension administration. The majority of Funds have a pensions committee overseeing investments.</td>
</tr>
</tbody>
</table>

* Source: IPSPC.

a There are equivalent arrangements for schemes run by Devolved Administrations. In Northern Ireland the Department of Finance and Personnel appoints the Accounting Officers who are responsible to the Northern Ireland Assembly. In Scotland, Ministers have devolved responsibility for five public service schemes; the day to day running is delegated to an appropriate Accountable Officer.

b ibid.

c ibid.
6.5 There are a great variety of governance arrangements in the public service pension schemes. Some unfunded schemes have governance groups which look at scheme pressures and reform proposals in detail, while others have bodies for negotiating rule changes which do not involve the same level of detailed scrutiny. These groups and bodies include employee representation. Such governance and negotiating groups can only be advisory on matters of policy as the relevant Secretary of State is responsible for policy and for setting scheme rules and is ultimately accountable to Parliament for policy decisions.

6.6 However, only one unfunded scheme, the Principal Civil Service Pension Scheme (PSCPS), has a formal pension board, responsible for managing the scheme in accordance with its governing legislation and rules and for the stewardship of the resources it consumes.

6.7 The Local Government Pension Scheme (LGPS) has a range of local pension committees which consider various matters, including local discretions under national scheme rules and investments, but these do not have the legal status of trusts. At present their fiduciary duty for the Fund monies is to taxpayers rather than to members and other beneficiaries (as it would be in a trust based scheme) and overall responsibility for the scheme lies with the Secretary of State for Communities and Local Government. The Policy Review Group for England and Wales run by the Department for Communities and Local Government (DCLG) considers possible changes to rules.

6.8 This position, for both the unfunded schemes and the funded LGPS, contrasts with trust based funded schemes in the private and public sector. These are required by law to have a board of trustees, usually consisting of a fixed number of members (management; nominees of employees and pensioners; and independents). These are required to have knowledge of their scheme (often involving training), meet regularly and oversee pension administration.

6.9 Ultimately the board of trustees is legally responsible for the operation of the scheme, including effective administration of benefit payments and communications with members, the investment of scheme assets, setting appropriate funding principles and plans to recover deficits and ensuring adequate internal controls are in place. The scheme rules are set out in a trust deed, but the powers to amend this deed and the roles of employer and trustees in making amendments vary considerably from scheme to scheme. While there are valid reasons for the difference between the governance models of the public and private sectors, lessons can be learned from the trustee model.

Establishing good governance

6.10 The current arrangements described above mean that there is sometimes no clear separation of duties between those responsible for policy changes, for the governance of the schemes and the delivery of administration. For example, between those charged with...
setting the scheme’s rules, those who oversee the schemes and their financing and those who implement changes in scheme rules and handle other administrative tasks.

6.11 Some of these responsibilities fall to departments running schemes, some to employers and some to contractors. This can lead to a lack of transparency and clarity (for members and the public) as to who is responsible for what, which in turn can confuse lines of responsibility and accountability. To provide greater clarity, avoid conflicts of interest and help increase the focus on efficiency and effectiveness there needs to be clear separation between these roles.

6.12 Evidence presented to the Commission\(^3\) (both in the second call for evidence and in stakeholder roundtables) suggested that where there currently are boards, groups or committees, members of public service pension schemes (both funded and unfunded, centrally run and locally administered) are sometimes not formally represented, for example, by nominees specifically elected by the members. In some cases representatives of the workforce covered by the scheme, such as union officials, sit on formal governance or negotiating groups, but schemes vary greatly in this and in the extent to which there is formal member involvement.

6.13 But there are examples of good practice, for example, the majority of local authorities have some form of member representation in their governance arrangements. In November 2008 DCLG issued statutory guidance to local authorities administering pension schemes requiring them to publish governance compliance statements grading themselves against 17 criteria, ranging from the structure of and representation on their pensions committee through to frequency of meetings, voting rights and the training of members. A DCLG survey found that 96 per cent of the 89 local authorities in England and Wales classify themselves as compliant with that guidance. The 2010 annual survey of LGPS funds conducted by the National Association of Pension Funds has found that about 90 per cent of Funds have a LGPS member or a trades union representative on their main pension committee.\(^4\)

6.14 However, it seems that only a minority of member representatives have full voting rights. UNISON submitted evidence to the Commission that by, 2009, only seven of the 89 England and Wales Fund authorities had allowed voting by scheme members of pension committees. This difference reflects current limitations on Committee members’ roles, for example, where democratically elected councillors are responsible for individual Funds. But there does seem to be some room for improvement in this area; without a standard requirement for member representation members may not feel adequately involved in decisions concerning their pension scheme.

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3 See Annex D.
4 NAPF Annual Survey 2010 consisting of 24 Local Government Pension Schemes.
Recommendation: Every public service pension scheme (and individual LGPS Fund) should have a properly constituted, trained and competent Pension Board, with member nominees, responsible for meeting good standards of governance, including effective and efficient administration (Recommendation 17a).

6.15 The Commission believes scheme members in all the public services should be able to nominate persons to pension boards and committees along similar lines to the rights of members in the private sector to nominate persons to sit on boards of trustees. Pension boards should therefore include independent professionals and scheme members in similar proportions as apply in the private sector to boards of trustees. It is also very important that as well as the ‘lay persons’ there are also independent members, usually professionally trained and with experience of the pensions environment.

6.16 Good board member appointments and behaviours are arguably more important than board structures and much can be learned from good examples, both in the public and private sectors. There will need to be coherent policies on the appointment of members. It will be crucial to the success of pension boards that members have appropriate training and that employers help board members to commit enough time to their duties. Clear guidance will be required for members of pension boards on their role and duties. They would fulfil similar duties to trustees, acting in accordance with scheme rules, impartially and prudently, balancing the interests of scheme beneficiaries and of taxpayers. There will be a need for effective committee structures to facilitate sound decision making and strong oversight of scheme administrators and fund managers.

6.17 It will be important that measures are put in place to ensure clear separation of duties and the avoidance of conflicts of interest by the members of the pension board.

6.18 The Commission recognises that progress has been made in the area of governance structures across the centrally and the locally managed schemes. Two examples of how some improvements have been delivered so far are set out below: the first covers the introduction of a formal pension board to an unfunded scheme, the PCSPS, shown at Box 6.B; the second describes the governance arrangements for a local funded scheme, the London Pension Fund Authority and is shown at Box 6.C.

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5 The Pensions Act 2004 stipulates that all trustee administered pension schemes should have a minimum of one-third of trustees nominated by members of the scheme.
Box 6.B: Principal Civil Service Pension Scheme (PCSPS) Governance

The PCSPS covers over 200 employers and has 1.5 million members. Following a review of PCSPS administration, the Cabinet Office has transformed administration arrangements and governance, adopting best practice in the private sector, where possible.

A twelve member Scheme Management Board was set up in April 2010 chaired at Permanent Secretary level with four members’ representatives, four representatives from scheme employers, one representative of central government (HM Treasury) and two (non-voting) non-executive members who chair the Board’s Risk and Operations Committees. All Board members were selected on the basis of having relevant experience in areas such as finance and human resources.

The Board’s terms of reference specify its role as:

- managing the Scheme in accordance with the relevant legislation and rules;
- developing and managing a risk management framework and internal controls system; and
- oversight of the Scheme administrator.

As Scheme Manager (with responsibilities akin to a trustee board for a private sector scheme) the Board reports to the Head of the Civil Service, who is the Accounting Officer and is in turn responsible to the Secretary of State and ultimately to Parliament. The Board oversees improved service for members while at the same time providing reassurance to employers, and ultimately the taxpayers who fund those employers, that the Scheme’s administration gives value for money.

The Board is supported by an executive that manages relationships with the Scheme administrators and the employers covered by the Scheme. The executive has participation agreements in place with each employer, which set out their responsibility to provide accurate data and the right financial contributions to the Scheme.
**Box 6.C: London Pension Fund Authority (LPFA) Pension Board**

The LPFA is a statutory body, with a local authority’s powers in relation to the LGPS, although unlike almost all other LGPS Funds it has been set up independent of direct local political control. It has over 200 employing authorities and 73,000 members. The LPFA has a constitutional document setting out a formal governance structure of its pension board and committees.

The LPFA Pension Board Chairman and Vice Chairman are appointed by the Mayor of London and are independent of the employers covered by the fund. The Mayor appoints a further nine board members following public advertisement, five of which are subject to consultation with representatives of London local government. The aim is to have a mix of board members with a variety of skills including investment management, business, pensions finance, local government finance, general management and corporate social responsibility.

The Board regularly meets and reviews its strategic objectives for the medium term, including the investment strategy. The Board delegates business to its committees which review investments, performance, administration and auditing. In addition, a remuneration committee and an urgency committee meet on an ad hoc basis as required. For example, the Board sets the overall investment policy and strategy of the Fund and the investment committee is responsible for implementation, including the appointment of Fund managers and monitoring the performance of the Fund and of investment managers against targets.

Regular newsletters are sent to all members and all employers. Annual forums are held for Fund members and employers. A Fund member panel has been established and is invited to attend each board meeting. A formal panel meeting is held after the Board with board members and senior officers in attendance. There is also an employer panel with similar arrangements.

**6.19** The introduction of new governance arrangements would not diminish the role of the responsible government minister who will remain legally responsible and in overall control of each scheme, or that of the formally appointed accounting officers for schemes, nor, for LGPS Funds, would it replace the statutory administering authority responsible for implementing ministers’ policies and regulations. This reflects the point that these pension promises are backed by the State, and therefore taxpayers, and that the legislative and executive arms of government should retain overall responsibility for public finance and expenditure.

**6.20** A diagram showing the responsibilities that the public service pension boards would be expected to perform is shown at Box 6.D.

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6 The Fund is usually controlled by locally elected councillors.
Box 6.D: Proposed governance arrangements for scheme administration

Pensions Board
- enforcing the rules
- oversight of scheme administration
- appointment of scheme actuary and auditor
- risk management and internal controls
- oversight of financial management
- investment management (LGPS only)
- oversight of appeals

Scheme Administrator
- maintenance of records, collection of contributions, calculation of benefits, communications with employers and members, publication of data, financial management, processing appeals, ill health benefits

Investment advice
(LGPS only)

External advisors
(auditors, scheme actuaries)

Employers

Data & contributions

Scheme members

Source: IPSPC.
6.21 The Pension Board would focus on the implications of administering pension scheme rules. However, even if all schemes have a pension board in future, there will still be a need for separate pension policy groups to consider at national level major changes to scheme rules and the value of the pension scheme to the membership. As noted in paragraph 6.5 above, many schemes have such groups or bodies. These tend to be established as part of the consultation and negotiation machinery for handling pensions as an element of the remuneration package and to have member and employer representation as appropriate. The Government should introduce such groups for the schemes that do not have them. All policy review groups should ensure that information about key proposals for change and related costs is publicly available.

**Recommendation:** There should also be a pension policy group for each scheme at national level, for considering major changes to scheme rules (Recommendation 17b).

### Locally administered schemes

6.22 The Commission does not propose rationalising governance and administration of local schemes through moving to wholly national arrangements, instead advocating greater co-ordination and collaboration consistent with retaining local identity and accountability. There would be some efficiency to be gained from putting the locally run schemes (the LGPS, police and firefighters schemes) fully on a national basis, so that they were run in the way that the scheme for locally-employed teachers in England and Wales is run. However, the Commission recognises that such a potential change raises issues to do with local accountability and the role of democratically elected local government representatives, which goes beyond consideration of good governance for pension schemes. Equivalent considerations apply to the separate schemes run by Devolved Administrations, such as the schemes for NHS staff in Scotland and in Northern Ireland.

6.23 Neither does the Commission advocate a uniform governance model in terms of the way responsibilities are allocated within the updated governance structures. The Commission has been given examples of best practice in pension scheme governance and evidence of how different schemes have established their governance structures and it is clear that a variety of different models operate across the public service schemes to good effect.

6.24 However, where schemes with nationally determined rules are administered locally, as is the case for the LGPS, police and firefighters schemes, there is a case for supplementing local pension boards with a national pension board for each scheme separate from the individual local authorities and employers. The locally administered schemes are a hybrid of

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7 There are, for example, such groups for most of the very big schemes: NHS and Civil Service Pension Scheme Governance Groups; a Teachers Pensions Committee; the Police Negotiating Body; the Fire Pensions Committee; and the LGPS Policy Review Group.

8 In some cases these groups operate separately from the remuneration negotiations between employer representatives and members.
nationally set statutory scheme rules, subject to a minor amount of local discretion and local management.

6.25 It would be for the Government to decide how they would be set up, for example, whether this would be under the Department responsible for the scheme’s rules or another body. These national pensions boards might build on existing arrangements such as operated by the Local Government Association and the Local Government Employers organisation for the LGPS in England and Wales.

6.26 The role of national pensions boards in respect of the locally administered schemes would be facilitative. While not taking on a regulatory or oversight role national pensions boards might help analyse and recommend on comparative performance of governance and administration. They might point to the scope for efficiencies in those areas that raise standards across the piece. In the case of the LGPS, their national pensions board could also look at overall funding and the comparative performance of individual Funds, fostering links between different individual LGPS Funds and perhaps making recommendations on opportunities to capture efficiencies and to improve investment performance. The boards could include nominees of individual scheme members and employers as well as those responsible for national scheme rules and local financing.

Transparency

Communication with scheme members

6.27 Not all schemes communicate with active members on a regular basis. Currently defined contribution schemes are required to provide members with an annual benefit statement which shows a statutory money purchase illustration, based on a number of assumptions, projecting a possible income in retirement. However, almost all public service pension schemes are defined benefit and defined benefit schemes are formally required to provide a statement only if the member requests one.9

6.28 Some public service schemes do provide annual statements that may show information such as a projected annual pension and lump sum if the member retires10 at their Normal Pension Age (NPA), or had died or retired on ill health grounds, or otherwise took a pension around the date the statement was produced. But some schemes do not provide regular statements to members.

6.29 The Commission considers that regular updates to scheme members regarding pension benefits earned to date and forward projections of pensions are crucial in improving general pension education and in promoting a sense of personal ownership of pension benefits.

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10 This may be based on same level of pensionable pay that would be used to calculate an immediate pension award but assuming that level continues in future.