Public Service Pension Schemes

November 2015

Risks and Governance

The successful functioning of a public service pension scheme needs the careful attention of a number of different parties, each with different roles and responsibilities. The Government Actuary, Martin Clarke, recently spoke on this subject at an event for Audit and Risk Assurance Committee members. Following on from his presentation, this briefing considers some of the challenges around risk and governance facing public service schemes. How can risks be mitigated and what is the role of Audit Committees?

Background

In March 2011 the Independent Public Service Pensions Commission published its final report making recommendations for changes to public service pensions. The Coalition government accepted the Commission's findings and legislated for many of the recommendations through the Public Service Pensions Schemes Act 2013. This Act provided for new, reformed, schemes to be established for eight main workforces[1] across the public sector. Total scheme membership for these workforces stands at over 13 million individuals with total liabilities of over £1 trillion[2].

Risks

The main goal of all pension schemes is to pay the right benefits to the right people at the right time. For public service schemes, cost management and taxpayer protection are also very important. There are many risks in relation to these objectives. To highlight a few examples:

Record-keeping: The data needed to calculate pension benefits is extensive and has become more complex after recent reforms. Poor record-keeping can lead to incorrect payments to members.

Financial: Departments need to secure funding to finance the pension benefits being earned by employees. The cost of this is determined at four-yearly actuarial valuations. These valuations also measure the cost of the schemes against a benchmark (the 'cost cap' mechanism). Issues with membership data can lead to unexpected changes in cost and/or changes to members' future benefits or contributions. The sponsoring employers of funded schemes will also bear the consequences of investment risk, which depend on how scheme assets are invested.

Accounting: Schemes must account for their cashflows and liabilities annually. They must also provide 'supply estimates' to HM Treasury (HMT) of their net cash requirements and demand-led spending known as Annually Managed Expenditure (AME). If schemes overspend compared to these estimates this can cause cashflow difficulties in paying benefits and the accounting officer may be called before the Public Accounts Committee to explain why an 'excess vote' is required to provide further funding.

Change management: Schemes have been subject to significant change in recent years. Future changes – such as legislative changes affecting scheme benefits or taxation, or changes to administration systems – must be carefully managed to ensure they do not lead to errors arising in benefit payments or otherwise compromise good scheme management.

Managing suppliers: Schemes will use a range of suppliers such as administrators, actuaries and lawyers. Supplier issues can lead to incorrect payments to members or a breakdown in financial controls.

Reputational risk: Significant scheme issues can result in media interest and adverse publicity.

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[1] *civil servants, the judiciary, local government workers, teachers, health service workers, fire and rescue workers, members of the police forces and the armed forces*

[2] *as calculated for actuarial valuations of the schemes, generally as at 31 March 2012*

Examples: adverse outcomes and mitigations to avoid recurrence

Data quality – Qualified accounts; Material unforeseen extra department funding

Data quality is critical to the good management of the scheme. Schemes have had their annual accounts qualified due to auditors not being able to validate the accuracy of some benefit awards, leading to concerns about both the benefits paid and the calculated value of the pension liability.

Some schemes uncovered poor membership data during the 2012 actuarial valuations. In one case, deficiencies identified in the data used for the previous valuation would have caused an annual increase of several hundred million pounds in departmental funding. A significant exercise was required to reconcile and resolve the situation. Under the cost cap mechanism, member benefits could be affected if similar issues were to arise at subsequent valuations.

Mitigations include clear lines of responsibility for data quality with a regularly monitored data improvement plan. Such a plan might include, for example, an independent data and benefit calculation audit, working with GAD to identify key valuation data issues, and running regular pensioner verification exercises to minimise overpayments.

Financial reporting – Triggering an excess vote

In the past, a scheme has triggered an excess vote in relation to its supply estimates because of a change in timing of a transfer out of the scheme. Whilst schemes have the opportunity to amend their estimates mid-year, failures in communication and a lack of clarity of responsibilities meant this issue was spotted too late.

Clear, documented processes and ongoing communication between all parties can mitigate this kind of issue. GAD can help prepare or check pensions elements of these calculations and schemes may wish to include defensible contingency margins to help provide some leeway for unexpected events.

Governance framework

Each organisation in central government must have an Accounting Officer, typically its senior official, who is the person who Parliament calls to account for stewardship of its resources. The standards expected of the Accounting Officer's organisation are set out in Box 3.1 of Managing Public Money.

The Public Service Pensions Act gave the Pensions Regulator (tPR) an increased role in the regulatory oversight of public service schemes and tPR has issued a Code of Practice on their governance and administration. Schemes were required to implement a new governance framework, including:

- a Pension Board to help the scheme comply with relevant regulations and with tPR's requirements
- a Scheme Advisory Board to provide advice, on request, about changes to the scheme

Both the Pension Board and Scheme Advisory Board are non-executive boards. In addition the Act formalised the role of the Responsible Authority – typically the Secretary of State – who may make scheme regulations; and the Scheme Manager, responsible for managing or administering the scheme.

The role of the Audit and Risk Assurance Committee

As an oversight body, the Committee needs confidence that appropriate processes, systems and controls are in place and will be carried out to the necessary timescales. They need to know that all those who are responsible for looking after the scheme are doing their part, with sufficient knowledge and understanding. Questions to consider include:

- Is there clarity over scheme responsibilities?
- Does the scheme have processes and controls in place to avoid adverse outcomes but also to deal with any issues that do arise?
- How are the new scheme governance arrangements working in practice? Is appropriate management information provided?
- Do Audit Committee members understand pension risks and possible adverse outcomes? Are they sufficiently well equipped to provide challenging oversight?

If you would like to discuss any of these issues in more detail or have any questions please get in touch with your usual GAD contact or via our enquiries address.