

# Guide to the regulation of workplace defined contribution pensions



The Pensions  
Regulator

The Financial Conduct Authority (FCA) and The Pensions Regulator have jointly developed this guide to provide an overview of how workplace defined contribution (DC) pensions are regulated to protect the interests of consumers. It is particularly aimed at market participants such as trustees, advisers and pension providers.

The guide aims to:

- a. clarify the regulatory focus and approach of each regulator, how they interact and how they manage any overlaps in regulatory structure and shared risks
- b. demonstrate the common elements in the regulators' approaches
- c. address potential concerns that the differences in how trust-based and contract-based DC pension schemes are regulated could adversely affect member outcomes.

## **Protecting the interests of consumers**

Both trust-based schemes and contract-based schemes are capable of delivering good outcomes for members of workplace DC pension schemes. The Pensions Regulator and the FCA have similar expectations for scheme quality and member outcomes.

The FCA expects pension providers to ensure that customers are treated fairly in the same way that The Pensions Regulator expects trustees to act in the best interests of their scheme members. The protection of members' interests is being further reinforced by the minimum quality standards being developed by the Department for Work and Pensions (DWP).

## **Regulating the workplace DC pensions market**

The market for workplace DC pensions has evolved over many years. This has led to two main types of workplace DC pension scheme:

- occupational pension schemes (required to be 'trust-based' schemes)
- work-based personal pension schemes (commonly known as 'contract-based' schemes).

The appendix to this guide provides a high level summary of the main features of these schemes.

The employer, rather than the employee, selects a workplace DC pension scheme so it is appropriate that pension scheme members receive broadly similar levels of consumer protection regardless of the type of scheme that the employer chooses. This is especially important as an employer may not compare one type of scheme against another.

## Joining up the regulatory approach

As outlined above, it is the FCA's job to ensure that firms that provide contract-based schemes treat their customers fairly. In the same way, The Pensions Regulator expects trustees to act in the best interests of their scheme's beneficiaries. In both cases it is clear who is responsible for considering the interests of scheme members.

While The Pensions Regulator's remit focuses exclusively on workplace pension schemes, the FCA's responsibilities extend beyond workplace personal pensions and across a multitude of financial services. Although a completely identical regulatory approach across the two types of scheme is therefore not feasible, the regulators do have the same expectations for scheme quality and member outcomes.

The DWP is developing proposals for minimum quality standards in DC schemes. These standards will focus on areas such as governance, administration and charges in both trust-based and contract-based pension arrangements. Application of the quality standards will ensure that members are offered similar levels of consumer protection regardless of the type of scheme that the employer chooses.

The Pensions Regulator and the FCA will work with the DWP – along with any other relevant government departments, or regulators such as the Prudential Regulation Authority (PRA) – to incorporate these new requirements into their regulatory activities. For information on how these organisations currently work together, see the section below on 'Ensuring consistency and minimising any potential duplication'.

## Clarifying the regulatory focus and approach

### The Pensions Regulator

The Pensions Regulator's main regulatory focus for DC pension schemes is on the conduct of the trustees of trust-based schemes. It achieves its objectives through exercising the functions conveyed upon it by pensions legislation. Its published strategy for regulating trust-based DC pension schemes is to educate and enable, and to enforce if necessary. The Pensions Regulator's enforcement powers are typically used when breaches of pensions legislation are identified.

The Pensions Regulator expects trustees to ensure that the benefits of scheme members are protected and that the investment funds offered by the scheme continue to be appropriate for the membership.

The Pensions Regulator publishes codes of practice that give practical guidance on how to comply with the requirements of pensions legislation. It also publishes regulatory guidance which provides good practice information, education and assistance.

The Pensions Regulator expects trust-based DC schemes to exhibit the quality features set out in **Code of practice no. 13** (the 'DC code') and associated DC regulatory guidance. The code and guidance are underpinned by a number of DC quality features that describe those activities, behaviours and control processes that are more likely to deliver good member outcomes. The quality features, many of which are related to the requirements of pensions legislation, provide a way for trustees to demonstrate that they are complying with those legal requirements and following good practice.

The Pensions Regulator is a risk-based regulator. One of its core tasks for DC schemes is to identify and prioritise risks to member outcomes arising from how a scheme is administered or governed. This allows The Pensions Regulator to focus its regulatory interventions on areas which present the highest risks and where interventions will have the greatest impact. In order to do this, The Pensions Regulator reviews the landscape to identify areas of potential member detriment, categorises the risks and prioritises mitigation for these risks at a strategic level.

The Pensions Regulator also uses risk-based business rules and triggers to ensure that case-specific responses and strategic interventions are targeted and proportionate.

The Pensions Regulator assesses risks proactively through thematic work and intelligence services and reactively through casework.

Further information on The Pensions Regulator's compliance and enforcement policies for DC pension schemes can be found here: [www.tpr.gov.uk/dc-policy](http://www.tpr.gov.uk/dc-policy).

## **Proactive work**

The Pensions Regulator evaluates risks at a thematic level, on particular fields or market segments. It looks at how widespread certain risks are in particular segments and assesses the probability of those risks arising. The Pensions Regulator uses a number of different methods to identify and assess risks, including market surveys, market intelligence and management information from casework.

## **Reactive work**

The Pensions Regulator assesses risks at an individual case level, based on the facts of the case. It focuses on the same risks identified by thematic work but considers them at the level of the individual scheme and its circumstances.

The Pensions Regulator uses information and intelligence gathered through thematic work and casework to inform an overall assessment of the risks in the DC landscape. This overall picture provides an understanding of risks to good member outcomes which arise and how these risks are mitigated. This in turn informs The Pensions Regulator's DC strategy and influences, for instance:

- the topics selected for thematic reviews
- articulation of business rules and classification of cases
- development of DC regulatory approaches to support operational activity
- the need for tools to educate or enable trustees and other audiences such as employers.

# The Financial Conduct Authority

In addition to workplace DC pension schemes, the FCA's remit extends across a wide range of financial services. This includes individual personal pensions and also long-term savings products, such as investments, which are alternatives to pensions. All of these products are subject to the same FCA regulatory approach.

The FCA's regulatory focus across all lines of business is on both firms – the providers of contract-based schemes in the case of workplace pensions – and on the products they develop. The FCA has powers to make rules, investigate and take enforcement action. Firms also have an obligation to act fairly in line with the FCA's **Principles for Business**.

The FCA expects firms to design and maintain contract-based products that meet the needs of the intended target market. Firms must ensure that they pay due regard to the interests of their customers and treat them fairly. The FCA also recognises that advisers and employers have key roles to play as well. The FCA's approach is built on a number of principles which include:

- ensuring fair outcomes for consumers and markets. This is the dual consideration that runs through all its work and it assesses issues according to their impact on both consumers and market integrity
- being forward-looking and pre-emptive, identifying potential risks and taking action before they have a serious impact.

It has assigned every firm to one of four categories of conduct supervision: C1, C2, C3 and C4. These broadly reflect a firm's size and retail customer numbers or wholesale presence, and the corresponding level of risk the firm potentially poses. Each category is subject to a different level of supervision, allowing the FCA to use its resources as efficiently as possible.

## Supervising what matters

The FCA aims to protect consumers and ensure market integrity by examining the areas that have an impact on them. This means looking at far more than a firm's systems and controls and compliance with the rulebooks. It is interested in a firm's financial health and how it aims to make money, both now and in the future, and how its culture and strategies support fairness for consumers and markets. The FCA's approach also supports the promotion of effective competition in the interests of consumers.

## The FCA's three-pillar supervision model

The FCA's supervision work is based around three fundamental pillars of activity, which draw on ongoing analysis of each industry sector and the risks within them. Its work on particular issues and products and its responses to specific events feed in to its proactive work with firms. Every piece of work then enhances the FCA's view of a sector and the firms within it. This cumulative approach allows the FCA to design supervision strategies to the best effect.

### Pillar 1 – Proactive firm supervision

The FCA engages with firms to assess whether they have the interests of their customers and the integrity of the market at the heart of their businesses. It takes a forward-looking approach and uses judgement to address issues that could lead to damage to consumers or markets, with clear personal accountability for a firm's senior management.

## **Pillar 2 – Event-driven, reactive supervision**

When the FCA becomes aware of significant risks to consumers or markets, or when damage has already been done, it will respond swiftly and robustly. The FCA will ensure firms mitigate risks, prevent further damage and address the root causes of problems. If necessary it will use formal powers to hold firms and individuals to account and gain redress for those who have been treated unfairly.

## **Pillar 3 – Issues and products supervision**

The FCA looks at each sector as a whole to analyse current events and investigate potential drivers of poor outcomes for consumers and markets. It does this on an ongoing basis, so it can assess risks common to more than one firm or sector before they can cause widespread damage.

The appendix to this document contains further information on the regulatory and strategic objectives of each regulator.

## **Ensuring consistency and minimising any potential duplication**

Given the differences between the regulatory regimes overseeing each type of pension scheme, there is the potential for regulatory arbitrage – that is where people may seek to take advantage if the regulatory framework for one type of scheme is demonstrably different to the other in a way that leads to potential member detriment. The regulators and the Government actively work together to ensure that they identify regulatory arbitrage, manage it effectively and mitigate it where possible.

The FCA and The Pensions Regulator regulate with their respective statutory objectives in mind. Where both regulators have an interest in a particular area (for example work-based personal pensions) this leads to a risk of inconsistencies or duplication. The FCA and The Pensions Regulator look to minimise such occurrences and, if such circumstances do arise, they look for pragmatic solutions.

Given that the FCA regulates firms that provide contract-based pension schemes and The Pensions Regulator's remit is more about the schemes themselves, the regulators will take the lead on different kinds of activity, consistent with their respective regulatory remit, strategy and powers. The Pensions Regulator is more likely to take the lead where there are problems with an individual scheme and the FCA is more likely to take the lead where the issue is caused by the pension provider. If there are potential implications for both regulators, they will agree who should take the lead and may undertake a joint investigation if appropriate.

Example: At the end of 2013 the FCA and The Pensions Regulator worked together effectively to investigate a trustee firm and another related company which was suspected of inappropriate conduct. This investigation resulted in the FCA banning four individuals for incompetence or dishonest behaviour. For a press release relating to this case, go to [www.fca.org.uk/news/press-releases/fca-bans-four-disgraceful-failings-relation-occupational-pension-schemes](http://www.fca.org.uk/news/press-releases/fca-bans-four-disgraceful-failings-relation-occupational-pension-schemes).

There are many practical ways in which The Pensions Regulator, the FCA and other interested parties work together to ensure work is operationally aligned and shared risks are identified and managed. Key examples include:

- sharing, assessing and monitoring the risks to delivery of good retirement outcomes for members of workplace DC pension schemes through a Joint Risk Group
- ensuring that risks and other issues that arise are discussed at a high-level senior management forum comprising of the regulatory bodies and government departments (DWP and HM Treasury)
- identifying potential opportunities for joint working on thematic, supervisory and enforcement activities where there is a common interest.

The FCA and The Pensions Regulator also have a memorandum of understanding. This sets out, at a high level, how the regulators work together. For more information on how The Pensions Regulator and the FCA's regulatory activities align at an operational level, see [www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/fca-tp-r-joint-strategy](http://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/fca-tp-r-joint-strategy).

## Market participants

In practice most participants in the DC market interact with one of the regulators, so the potential for duplication does not arise.

## Employers

Employers have duties under automatic enrolment and obligations to maintain contributions into workplace pension schemes. The Pensions Regulator regulates both of these aspects.

When they choose a pension scheme, employers will not necessarily compare contract-based schemes with trust-based schemes. If employers do compare scheme types it will likely be with help from professional advisers. Many employers, especially smaller ones, may simply accept the scheme they are presented with. The employer may not know whether it is contract-based or trust-based. This underlines how important it is that the quality of any scheme an employer chooses can be assured regardless of its type. Most new DC schemes are likely to be either contract-based or master trusts.

## Advisers

In practice, the FCA authorises many advisory firms. However, in terms of providing advice to employers, the majority of this is not covered by conduct of business regulation.

There are constraints on how advisers can be paid. The FCA's **Retail Distribution Review** banned commission on all contract-based schemes, and investments used in trust-based schemes, with a requirement to separate out the cost of the advice ('consultancy charge') from the cost of the product. For schemes used for automatic enrolment, a consultancy charge is not permitted. This means that the cost of any advice cannot be taken from the scheme.

## Trustees

Trustees are the focal point for The Pensions Regulator's regulation of trust-based DC schemes as they are responsible for running the scheme in accordance with their various duties under the scheme's trust deed and rules, trust law, and pensions legislation.

## Master trusts

The Pensions Regulator is developing a voluntary assurance framework in association with the Institute of Chartered Accountants of England and Wales. This will enable trustees of master trusts to demonstrate the presence of the quality features set out in The Pensions Regulator's DC code. It will also enable employers to easily identify a master trust which incorporates The Pensions Regulator's quality features when choosing a scheme for automatic enrolment.

## Fund managers

The FCA regulates, from a conduct perspective, asset managers in whose funds the members of both contract-based and trust-based schemes may invest. The FCA also prudentially regulates fund managers who are not authorised by the PRA.

## Product providers

As contract-based providers are regulated by the FCA, but also interact with The Pensions Regulator on administration issues, they may have to deal with both regulators and potentially the PRA as well. At an operational level, product providers have become accustomed to these arrangements.

## Third-party administrators

Third-party administrators of workplace pension schemes are not directly regulated. The FCA expects firms that provide schemes to ensure the quality of administration as part of Systems and Controls (SYSC) requirements. While firms can outsource such responsibilities, they still retain the responsibility. Similarly The Pensions Regulator expects trustees to exercise due diligence when appointing an administrator and to have in place a process for monitoring against agreed service levels. The Pensions Regulator has powers to enforce against a third party (which might be a scheme administrator) to a trust-based arrangement where the administrator has, for example, caused the scheme's trustees to breach pensions law.

The diagram on the following page summarises how regulatory activities apply to some of the key market participants, broken down into contract-based and trust-based schemes. It also demonstrates the important difference between the regulation of pension schemes and the regulation of underlying investment management.

Members of pension schemes should be afforded broadly similar levels of consumer protection regardless of the type of scheme they are in. To achieve this, the regulators and the Government are working together to ensure a joined-up and cohesive approach to regulation.



## Contract-based schemes

### Providers

The FCA regulates the conduct of firms establishing, operating or winding up a personal or stakeholder pension

The FCA prudentially regulates providers who are not regulated by the PRA

The FCA regulates financial promotions and pre-sales disclosure

The Pensions Regulator promotes and improves understanding of good administration (for pension products)

The PRA prudentially regulates PRA-authorized pension providers

## Trust-based schemes

### Trustees

The Pensions Regulator regulates trustees who run trust-based pension schemes in the interests of scheme members

### Master trust providers

The Pensions Regulator regulates trustees of master trust providers

The PRA prudentially regulates providers of master trusts where they also provide other regulated investment products (eg insurers)

### Employers

The Pensions Regulator regulates employers in respect of maintaining contributions into occupational pension schemes and work-based personal pensions

The Pensions Regulator regulates employer compliance with automatic enrolment duties

### Advisers

The FCA regulates advice to members of contract-based schemes and investment advice to trustees. Advice to employers on scheme selection is not regulated. Intermediation (remuneration of intermediaries/regulated advice to individuals) is regulated.

Members' money invested



Members' money invested



## Provision of investments and investment management

### Fund managers

The FCA regulates the conduct of insurers and asset managers in whose funds workplace DC members may invest

The PRA prudentially regulates insurers and major asset managers in whose funds workplace DC members may invest, and the FCA prudentially regulates the other asset managers

## Appendix

### 1. An explanation of trust-based and contract-based arrangements

#### Trust-based schemes

Trust-based schemes are established under trust and administered by individual trustees or a corporate trustee (the 'trustees'). As trustees of these schemes, they have a general duty to act and exercise their powers in the best interests of the scheme membership. The Pensions Regulator is the regulator of occupational pension schemes and focuses mainly on the conduct of the trustees.

Trust-based schemes can be either single-employer or multi-employer. The Pensions Regulator defines a 'master trust' as an occupational trust-based pension scheme established by declaration of trust which is or has been promoted to provide benefits to employers which are not connected and where each employer group is not included in a separate section with its own trustees. For this purpose, employers are connected if they are part of the same group of companies (including partially owned subsidiaries and joint ventures).

#### Contract-based pensions

Contract-based pensions involve a contract between each individual member and a product provider. There is no direct contractual relationship between the employer and the product provider regarding the pension itself. The FCA is responsible for regulating the conduct (and, in some cases, the financial stability) of providers of contract-based schemes. The FCA's remit extends across financial services – including individual personal pensions – and its focus is on firms, such as product providers and advisers, who are active in the market. The FCA requires firms to pay due regard to the interests of their customers and treat them fairly.

Common types of contract-based pensions include group personal pensions and group stakeholder pensions.

### 2. Objectives of the regulators

While the regulators can be flexible in how they approach regulation, their overall objectives are set out in statute. In practice, as far as the regulation of DC schemes is concerned, both the FCA and The Pensions Regulator are primarily concerned with ensuring good outcomes for individuals who participate in workplace DC pensions.

The language used by each regulator differs however. The Pensions Regulator tends to refer to 'members' and the FCA to 'customers' or 'consumers'. The term 'consumers' in the FCA's statutory objectives and 'customers' in their Principles for Business includes members of contract-based schemes.

## **The Pensions Regulator**

The Pensions Regulator has the following statutory objectives which are relevant to DC pension provision:

- to protect the benefits of members of occupational pension schemes
- to protect the benefits of members of work-based personal pension schemes (where there is a direct payment arrangement)
- to promote, and to improve understanding of, the good administration of occupational and work-based personal pension schemes
- to maximise employer compliance with employer duties and the employment safeguards introduced by the Pensions Act 2008.

These are the main objectives of The Pensions Regulator in exercising the functions conveyed upon it by pensions legislation.

## **The Financial Conduct Authority**

The FCA is responsible for regulating the standards of firms' conduct in retail and wholesale financial markets and for supervising the infrastructure that supports those markets. The FCA also has responsibility for the prudential regulation of firms that are not regulated by the PRA.

The FCA has an overarching strategic objective to ensure that the relevant markets function well. This is embodied in its three operational objectives:

- to secure an appropriate degree of protection for consumers
- to protect and enhance the integrity of the UK financial system
- to promote effective competition in the interests of consumers in the market for financial services.

These objectives are the foundation of the FCA's approach to supervision.

Further information can be found at  
[www.tpr.gov.uk](http://www.tpr.gov.uk) and [www.fca.org.uk](http://www.fca.org.uk)

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