

Internal Controls – updated guidance

New guidance from the Pensions Regulator is providing pension trustees with a timely reminder of the need for good internal risk management.

The legal requirement

Under the Pensions Act 2004, trustees of occupational pension schemes must establish and operate adequate internal controls to ensure that schemes are administered and managed:

- in accordance with the scheme rules, and
- in accordance with legal requirements.

Internal controls are:

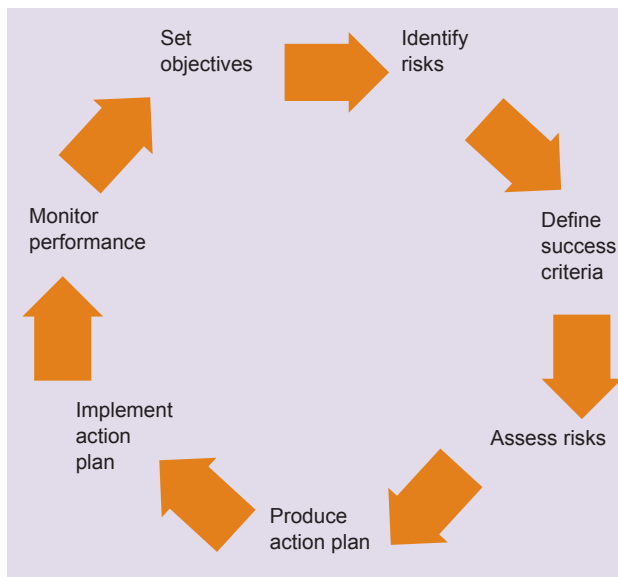
- arrangements and procedures to be followed in the administration and management of the scheme,
- systems for monitoring that administration and management, and
- arrangements and procedures to be followed for the safe custody and security of the assets of the scheme.

The legal obligation to operate adequate internal controls covers a broad range of functions including operational, financial, funding, regulatory and compliance issues. In other words, it covers the whole of a scheme's operation.

The Pensions Regulator's view

The Regulator considers that an adequate internal controls framework is a key feature of a well-run scheme, underpinning quality governance and providing reasonable assurances that members' benefits and scheme assets are protected.

The Regulator issued its Code of Practice on this subject in November 2006. The Code advocates that trustees adopt a risk-based approach to assessing and managing internal controls, in line with the risk management cycle reproduced in the diagram on this page.



New guidance

In June 2010 the Regulator issued detailed, updated guidance material, designed to give practical assistance to trustees. The guidance focuses on the following priority areas which are common risks in most pension schemes:

- lack of knowledge and understanding,
- conflicts of interest,
- ineffective relations with advisers,
- poor record-keeping,
- deterioration in employer covenant,
- investment risk, and
- ineffective retirement processes.

The list is not exhaustive: there will be other scheme specific risks. Trustees should evaluate all risks in a sensible order of priority, starting with those that have the greatest potential impact.

New e-learning modules accompany the guidance and contain useful examples - especially for those not wholly familiar with risk management in the context of pension schemes.

Whilst the guidance has been developed with smaller schemes in mind, the content is also relevant to larger schemes that have an existing risk management system.

The guidance re-emphasises the need for trustees to formally document risks and key controls in a risk register.

Action for trustees

Trustees with an existing risk management system in place should:

- consider the new guidance and assess whether their current processes are still fit for purpose,
- regularly (eg annually) review their risk management processes in any event, and
- review exposure to new and emerging risks on an ongoing basis.

Trustees that do not have a risk management system in place should implement one promptly.

How we can help

Hammonds' pensions team has implemented and reviewed risk management processes for a wide variety of trustee clients.

We would be happy to assist with kick-starting or reviewing your risk management system in the light of this new guidance.