Assurance Reporting on Master Trusts: ICAEW consultation document

December 2013

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Overview

Master trusts are an important and growing type of workplace pension with a significant role in delivering the Government's automatic enrolment reforms. However, the current regulatory framework is not strong enough and the NAPF has been calling for better regulatory oversight for master trusts to ensure action is taken against any poorly-run schemes. We therefore welcome The Pensions Regulator (TPR) and ICAEW's focus on improving the regulation and oversight of master trusts.

The NAPF membership includes a range of different master trusts, who have directly contributed to this response. The NAPF has a number of concerns about TPR's strategy for master trust regulation and with the ICAEW's proposed assurance framework.

1. The overarching concern of master trusts is with the significant level of resource that audits will require, both in the cost of the external audit and the large amount of internal work it will entail. These costs will ultimately be paid by members and come on top of the large levy schemes already pay to the regulator.
2. Schemes are also strongly concerned about the very limited capacity and pensions expertise in the audit industry and fear that demand will outstrip supply, pushing up costs and causing delays in getting assessments.
3. The regulator's DC Code and ICAEW's framework should not be seen as a substitute for the effective regulation of schemes by The Pensions Regulator. Appropriate resources need to be directed to the supervision of master trusts and TPR needs to be given the powers to effectively regulate.
4. As the audit is voluntary, there is a risk of a perverse impact on the market, with good, well-run schemes being burdened with the costs of the work to demonstrate compliance, while poorly-run schemes ignore the framework.

As a result of these and other concerns, the NAPF recommends that the ICAEW and TPR:

- Extend the implementation deadlines, given the lack of capacity in the audit profession and the fact master trusts will be busy implementing automatic enrolment during 2014;
- Reconsider the length and number of control objectives, as a shorter framework focused on the key risks and issues would be more efficient and effective;
- Set out how the framework will be updated in line with policy developments in the pensions arena, such as DWP's recent charges consultation; and
- Make the control objectives less prescriptive, and more focused on ensuring that governance is independent and effective, rather than setting out in detail what trustees should be doing.

The paper also sets out a series of more detailed comments on individual control objectives.

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About the NAPF

The National Association of Pension Funds (NAPF) is the leading voice of workplace pension provision in the UK. We represent some 1,300 pension schemes from all parts of the economy and 400 businesses providing essential services to the pensions industry. Ten million working people currently belong to NAPF member schemes, while around five million pensioners are receiving valuable retirement income from those schemes. NAPF member schemes hold assets of some £900 billion, and account for over one sixth of investment in the UK stock market. Our main objective is to ensure the security and sustainability of UK pensions.

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Background: The regulation of master trusts

1. Master trusts are an important and growing type of workplace pension. They are an ideal choice for many employers implementing automatic enrolment because they can offer both good value and strong, independent governance. The NAPF has long argued that the development of large multi-employer trust-based DC schemes would improve outcomes for UK pension savers. However, the regulatory framework for master trusts is not strong and there are few barriers to entering the market. The NAPF has, therefore, been calling for a stronger regulatory oversight for master trusts to ensure action is taken against any schemes which are poorly-run.

2. The NAPF is also working directly to set and improve standards for master trusts, through Pension Quality Mark (PQM) which was launched by NAPF in 2009. In February this year, PQM launched a new mark called PQM READY to recognise master trusts that have strong independent governance, low charges, and engaging member communications. Six master trusts have gained the mark: Legal & General Master Trust; National Pension Trust; NOW Pensions Trust; The Pensions Trust; The People's Pension; and Railways Pension Scheme. Several more have applied.

3. The NAPF has welcomed The Pensions Regulator and ICAEW's focus on improving the regulation and oversight of master trusts. The regulator's Code of Conduct for DC pensions (which forms the basis of the ICAEW's framework) is useful in setting out good practice and legal requirements in one place. However, the NAPF is concerned that, with only limited enforcement, these initiatives could have the perverse impact on the pensions market of burdening well-run master trusts with extra work to demonstrate compliance, while having little effect on those which are poorly run. The proposed voluntary nature of the audit framework could have the same perverse impact.

4. The NAPF has also expressed concerns about the DC Code being too prescriptive and detailed. The whole point of good trust-based governance is that trustees have the power and duty to act in their members' interests. Good regulation should be about making sure the trustees are effectively taking up these powers and duties, not trying to set out in detail how they should act. We are pleased that the Regulator listened to these concerns and that the final version of the Code published in November was shorter and less prescriptive. However, the danger remains of focusing on setting detailed requirements rather than making sure that the scheme governance is robust and independent.

5. Master trusts come in different shapes and sizes and a one-size-fits-all approach to regulation and oversight will not work. For instance, the risks associated with a very commercial scheme set up by an insurer will be very different from the risks with a small industry scheme. The regulator and ICAEW need to recognise this.

6. Overall, we do not believe the Code and the assurance framework are any substitute for the effective and proactive regulation of master trusts and other DC schemes by The Pensions Regulator. Master trusts already pay a levy to TPR of 86p per member, which means large schemes will be paying over £1 million each. The regulator needs to use some of this resource to

supervise master trust regulation, and it should be given the powers needed to regulate effectively. A voluntary audit framework risks both being a distraction from this task and creating an extra burden for master trusts, without solving the underlying problem of poor regulation. It could also create false comfort for the industry and scheme members, without actually enhancing the direct protection available to members.

Commentary on the ICAEW framework

7. To develop its response to the ICAEW framework, the NAPF consulted with master trust members in its DC Multi-Employer Scheme Forum. This forum contains a range of different types and sizes of master trusts, and also a number of advisers to master trusts.

8. The overarching concern of the forum members is the level of resource these audits will require, both in terms of the cost of the external audit and the very large amount of internal work to make sure documentation is ready and correct. The costs of the audit could be significant and will ultimately be paid for by scheme members, and comes on top of the large TPR levy.

9. Linked to this is a concern about the very limited capacity and pensions expertise in the audit industry. Schemes fear that all master trusts seeking an audit at the same time will lead to demand outstripping supply and therefore much higher costs or long delays in getting assessments. Using auditors without enough understanding of pensions risks even higher costs, as the audit will take longer and be very difficult to complete.

10. The timing of this is particularly bad, as the audit work will hit master trusts just as they reach the peak demand from employers because of automatic enrolment. In light of this, and the lack of capacity in the audit profession and within master trusts during 2014, the NAPF urges the ICAEW and TPR to reconsider the implementation deadlines. It also calls on them to reconsider the length and number of control objectives, arguing that a shorter framework targeted at the key risk issues would be more efficient and effective, and could be built on at a later date.

11. Looking at the framework in more detail and the proposed 43 control objectives, members of the Forum identified several main concerns:

    - In places the control objectives are too prescriptive. The auditors should check that trustees have properly considered an issue but not try to audit whether they have found the correct solution – as only the trustees can judge this.
    - Pensions policy is changing rapidly and a number of the controls are already being overtaken by events, such as new proposals on charges from the DWP. How will the control objectives be kept up-to-date in this evolving policy environment?
    - A lack of clarity about expectations and the rationale for some of the objectives risks auditors gold-plating standards or inappropriately transposing concepts from other industries to fill the gaps.

- The control objectives do not always take account of the wide variety of different types of master trusts, and the different risks involved.

12. Detailed comments on individual control objectives are in the table below.

Control objectives	NAPF comment
1-6: business risks and disaster recovery	These controls appear to be too prescriptive. Discontinuance plans may not be necessary for all master trusts. The requirement should be for trustees to have considered the risks and to have a risk register. If the risks of wind-up, transfer of ownership or insolvency are high, the trustees must of course make plans. But the audit process should encourage them to focus on the right risks for their scheme, not ones that could be superfluous.
7 & 8: data quality and security	Data quality is extremely important but the wording of objective 5 is worryingly absolute and categorical, given that no data set can ever be 100% ‘complete and accurate’. In the real world scheme members are continuously moving and not informing their pension scheme. The Regulator’s Code of Practice on data recognises this and sets targets below 100%. The wording needs to be changed to clarify what the expectation is.
9 – 12: protection of assets	We are concerned that understanding amongst auditors, regulators and others about protection and compensation arrangements in trust-based pensions is currently low. The situation is complex and subjective and there is scope for these objectives to cause confusion. For instance, the protection of holding a pension under trust is arguably more important than other safeguards. It would make more sense to have a simpler, broader objective of sensible controls and safeguards of assets, rather than anything prescriptive.
13 & 14: value for money	Although trustees are always considering what constitutes best value for their members as part of their ongoing duties, the concept of a ‘value for money strategic review’ will be quite new for most schemes. There should be more clarity about expectations or this could generate a huge amount of expensive or unnecessary consultancy work, which will increase rather than reduce costs for scheme members. Therefore, objective 14 should not be implemented until the Regulator has set out what its expectation is.
15 – 17: charges and communication	Transparency on costs and charges is extremely important, particularly so that employers can make informed choices on behalf of their employees. We welcome the reference to the joint industry code on pension charges, as it makes sense for the industry to use one definition. However, the new DWP consultation on charges means there is uncertainty on whether there will be new rules implemented in 2014. It probably makes sense to wait until this uncertainty is resolved before finalising these control objectives.
18 – 26: investments	These objectives appear to be over-engineered and a number (such as 18 and 19) duplicate each other. The number of objectives in this area could be reduced and set at a higher level so they are less prescriptive.

	Objectives 19 and 26 appear to encourage trustees to focus on the short-term performance of fund managers, when as long-term investors trustees should spend more time focusing on investment risks and strategy. In contrast, there is little focus in these objectives on investment risk. The wording of 26 is overly-prescriptive, as schemes may not want to use 'industry benchmarks' but set their own, particularly where they are using more innovative investment strategies.
27 – 31: conflicts and fit and proper trustees	There needs to be a clearer explanation of what is meant by 'fit and proper' in the pension trustee context – otherwise there is a risk that concepts from other areas will be inappropriately transposed. Does TPR envisage a process similar to getting on its independent trustee register? Some master trusts with member-nominated trustees would need to significantly amend their processes to implement this.
32 – 35: third parties and risk management	Schemes are already doing these things.
36 – 39: scheme transactions and payments	Third Party Administrators already have their own AAF reporting framework. The ICAEW need to make sure there is full alignment with these and no duplication. Some of these objectives set very prescriptive time limits. For instance, it is not clear where the five days in objective 38 comes from, and from what point it should be measured. Many schemes have weekly cycles so it is unclear if this will fit. Objective 36 says reconciliation must happen monthly, but many schemes will be doing this on a live version, so again the wording is overly prescriptive.
40 – 41: retirement options	Objective 40 is too detailed and prescriptive. Good practice will evolve rapidly in this area over the next few years and this risks stopping innovation.
42 – 43: investment communications	Objective 43 risks becoming tick box if master trusts feel this requires a certain formulation of words to be communicated a certain number of times a year – which would not be helpful.

Conclusion and recommendations

13. The current regulatory framework for master trusts is not strong and the NAPF has been calling for better regulatory oversight for master trusts to ensure action is taken against any poorly-run schemes. Therefore, we welcome The Pension Regulator (TPR) and ICAEW's focus on improving the regulation and oversight of master trusts. However, the regulator's DC Code and the assurance framework are not a substitute for the effective and proactive regulation of master trusts and other DC schemes by the Pensions Regulator. The Regulator needs to direct

appropriate resources to the supervision of this important segment and be given the powers needed to effectively regulate.

14. The NAPF membership includes a range of different master trusts, who have a number of concerns about the proposed framework. In particular they are concerned about the costs and resources these audits will require, the lack of capacity and pensions expertise in the audit profession, and the prescriptive nature of some of the control objectives.

15. As a result of these concerns the NAPF recommends that the ICAEW and TPR:

    - Extend the implementation deadlines, given the lack of capacity in the audit profession and the fact master trusts will be busy implementing automatic enrolment during 2014;
    - Reconsider the length and number of control objectives as a shorter framework focused on the key risks and issues would be more efficient and effective;
    - Set out how the framework will be updated, given the speed of policy developments in the pensions arena; and
    - Make the control objectives less prescriptive and focused on ensuring that governance is independent and effective, rather than setting out in detail what trustees should be doing.