Occupational Pension Schemes (Master Trusts) Regulations 2018

ICAEW welcomes the opportunity to comment on the *Occupational Pension Schemes (Master Trusts) Regulations 2018* published by DWP on 6 December 2017, a copy of which is available from this link.

We note that the short, six week consultation period (which is half the recommended 12 week period, see https://www.gov.uk/government/publications/consultation-principles-guidance) and which spanned the Christmas holiday period was too short to allow ICAEW to undertake a detailed consultation with our members affected by these changes, and therefore in some areas our response is limited to major points rather than detailed responses to questions. We are also concerned about the DWP's ability to draw valid conclusions from the consultation exercise, given both the short consultation period and the timing of it (being over the Christmas period).

This response of 12 January 2018 has been prepared on behalf of ICAEW by the Audit and Assurance Faculty. Recognised internationally as a leading authority and source of expertise on audit and assurance issues, the Faculty is responsible for audit and assurance submissions on behalf of ICAEW. The Faculty has around 7,500 members drawn from practising firms and organisations of all sizes in the private and public sectors. This ICAEW response also reflects consultation with the Business Law Committee which includes representatives from public practice and the business community. The Committee is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies.

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MAJOR POINTS

Audit requirements for scheme funders

1. We note that the regulations will require scheme funders ("Funders") to provide the Regulator with full audited accounts to ensure that their financial reports are verified by an independent third party (Paragraph 56 of the consultation). However, the requirements for the auditor's report in draft Regulation 9(3*) Scheme funder requirements: accounts* are not in line with Companies Act 2006 ("Companies Act") requirements and International Standards on Auditing (ISAs) (UK).

2. Broadly, under s495 of the Companies Act, auditors are required to opine on whether the accounts give a true and fair view and that they have been properly prepared in accordance with the relevant financial reporting framework, which would include consideration of going concern including where relevant the directors' identification of any events or conditions that constitute a material uncertainty that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting. In addition, the requirements in ISA (UK) 570 paragraph 21-2(b) state that (i) for entities that do not follow the UK Corporate Governance Code, the auditor reports by exception if use of the going concern basis of accounting is not appropriate or if management has not disclosed any material uncertainties or (ii) for entities that follow the UK Corporate Governance Code, the auditor states whether there is anything material to add or draw attention to the directors' statement on the going concern basis of accounting and the directors' identification of any material uncertainties. The requirement in proposed regulation 9(3)(a) that the auditor 'confirms whether, in his or her opinion the [Funder] is a going concern' is therefore inconsistent with Companies Act requirements and ISAs (UK).

3. If DWP's intention is to extend the existing reporting requirements to the audits of Funders that are not performed in accordance with ISAs (UK) (for example if the Funder is incorporated outside the UK and audited by a non-UK auditor), then this needs to be clarified in the regulations. For example, the regulations could refer to Companies Act and ISA (UK) accounts and audit requirements plus equivalent overseas accounts and audited requirements where relevant.

4. If DWP's intention is that auditors give a positive statement on Funders' continuance as a going concern, then this would need to be in a report that is separate from the audit report and, at the very least, would require the auditor to perform significant extra work and the Funder to incur significant additional fees, which are not reflected in the Impact Assessment. The reference to 'going concern' would need to be defined more clearly; for example over what timeframe is the going concern assessment being made? It would also be necessary for the Funder to provide an assertion in respect of its going concern upon which the auditor would report. Further, it would need to be clear as to the extent and nature of the work the auditor is expected to perform. This will require regulatory guidance for Funders and professional guidance for auditors to be developed and put in place. Without this level of clarity, we are concerned that auditors may not be willing and able to accept engagements to perform this additional reporting; if this is the case, Funders would be unable to comply with the legislation.

5. The requirement in proposed regulation 9(3)(b) that the auditor 'confirms whether the [Funder] is receiving financial support from another party', is new and would not be within the scope of an audit appointment. This requirement would necessitate an additional separate appointment, probably on an assurance basis and for which a framework would need to be developed, which would set out a requirement for a party (probably the Funder) to make an assertion as to what financial assistance is being provided by a third party, and the process that the reporting accountant would follow to provide independent reporting on such a statement. This would also give rise to additional fees, which are not reflected in the Impact Assessment. Alternatively, if the information on financial assistance were included in the Funder's financial statements, then

it would be subject to audit, and we would be happy to work with you to develop a reporting framework along these lines. The acceptability of this route to the auditing profession may depend on the development of such guidance.

6. It is also worth noting that provision C.1.3. of the UK Corporate Governance Code published by the Financial Reporting Council (FRC) requires directors to state ‘whether they considered it appropriate to adopt the going concern basis of accounting … and identify any material uncertainties to the company’s ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements’. The FRC has also published guidance along similar lines for directors of companies that do not apply the UK Corporate Governance Code, in *Guidance on the Going Concern Basis of Accounting and Reporting on Solvency and Liquidity Risks*.

7. In the light of the existing requirements, it may be preferable instead to align the requirements in proposed regulation 9(3) with the Companies Act and ISAs (UK) or, indeed, not to include these requirements at all as the existing requirements may be considered to suffice.

Systems and processes

8. As we mention at paragraphs [30-32] below, we would be keen to work with the DWP and TPR to develop their list of systems and process requirements to be included in the underlying Code of Practice (“Code”), as this could build on the work we have already done in developing the Master Trust Assurance Framework, which has been adopted by many of the leading master trusts. That framework provides TPR valuable assurance about the top level governance controls that trustees need to put in place including trustee oversight of the types of systems and processes carried out on their behalf referred to in Schedule 4 to the draft regulations, rather than providing assurance over the underlying systems and processes themselves. However, we would welcome the opportunity of working with you to see how the MTAF could be refined and/or to look at alternative sources of information to provide to TPR. However, we note there will be additional costs for schemes in making this kind of detailed operational information available to TPR.

9. We would welcome the opportunity to work with you as to how the underlying Code could apply ‘assurance mapping’ of the systems and processes requirements to determine to what extent and breadth the trustees of master trusts require information to satisfy themselves that the correct level of assurance is being obtained.

Whistleblowing and the Master Trust Assurance Framework

10. We note the draft regulations do not provide clarification of whistleblowing duties in terms of acting as a Reporting Accountant providing an assurance report to master trusts under ICAEW technical release TECH 12/16AAF (the Master Trust Assurance Framework). This issue was deliberately not addressed in the technical release due to the lack of certainty as to how the whistleblowing legislation applies to these appointments. In our view, the draft regulations should be amended to clarify this issue, so that reporting accountants are clear whether or not their appointment as reporting accountant brings them into the ‘statutory duty to report’ regime which applies to, for example, scheme auditors and actuaries.

11. Some of our members thought it could be beneficial to extend the whistle-blowing regime to scheme funders since they will now be under remit of TPR. However, this may need primary legislation as the basic whistleblowing requirements come from the 1995 and 2004 Acts. Others of our members thought the fact that the Trustees will be captured under the existing regulations was sufficient. However, it may be helpful if TPR provided clarity through the Code.

Balance between Regulations and Code

12. These draft regulations currently include a lot of detailed requirements that should instead be included in the underlying Code, so that the regime can be more flexible and better able to keep pace with developments. For example, three years ago, how many scheme business

plans would have provided for a Brexit scenario? Similarly, any systems requirements will need to be kept under constant review to keep pace with developments in technology, cyber security threats etc, and therefore should be included in a Code of Practice. See also our more detailed comments at paragraphs [17, and 23 and 30] below.

Ear-marked schemes

13. We understand that several Master Trusts are set up as Ear-marked schemes and the ICAEW therefore considers the governance regime for any such Master Trusts that are 'ear-marked schemes' needs to be reviewed. Ear-marked schemes with 20 or more participating employers have no audit oversight which, given recent advances in governance standards, would no longer seem to be appropriate for those that are Master Trusts. Furthermore, we note that respondents to the FRC's consultation on the revision of PN 15 raised concerns over the interpretation of the definition of ear-marked schemes, suggesting that even though they have been around for many years there is still a risk that schemes which were not intended to be covered by the audit exemption are taking advantage of it. We therefore believe the government needs to review the governance regime for Master Trusts that are ear-marked schemes to determine whether their audit exemption should be abolished (for instance, by amending the audited accounts regulations (1996/1975) so that this exemption would only be available for ear-marked schemes that are not master trusts). See also our more detailed comments at paragraphs 37-39 below.

Timescale and timing of the consultation

14. We would also point out that the six week consultation period, which spanned the Christmas holiday period, was too short to allow ICAEW to undertake a detailed consultation with our members affected by these changes, and therefore some of our response is limited to major points rather than detailed responses to questions.

RESPONSES TO SPECIFIC QUESTIONS

Q1. The scope of the authorisation regime is intended to ensure that multiple employer, mixed benefit schemes are captured and that the members are protected by existing pension legislation in respect of any defined benefits and by the Master Trust authorisation regime in respect of any money purchase benefits. Do the disapplications undermine this intention?

15. We are generally happy with DWP's stated intentions regarding the scope of the regime, but we are not in a position to comment on whether the detailed drafting of the proposed regulations will achieve those intensions.

2. For all the regulations in this section is it clear to the schemes concerned whether they are required to be authorised or not?

16. We are not in a position to comment on whether the detailed drafting of the proposed regulations will be clear to schemes.

3. Is it clear who will fulfil the roles subject to the fit and proper assessment in your scheme? Have we captured the important roles?

17. The 'fit and proper' criteria are another area that should be set out in an underlying Code, rather than enshrined in law, so as to provide flexibility. We also note that some of the tests in Schedule 1 are very woolly, e.g. "the person's credit history", which is not appropriate for statutory regulations.

18. The requirements should be equally applicable to scenarios where there are individual trustees and a corporate trustee, and we are concerned that currently it is not clear how these requirements would operate if a trustee is a corporate trustee. We note that the 2015 Charges

and Governance regulations attempt to deal with this in connection with the requirement to have three trustees, but this is not followed through into these regulations.

19. We are also concerned that there is no right of appeal in circumstances where TPR has assessed that a specified key person is not fit and proper. (The functions of TPR under the Pensions Act 2004 were extended by the 2017 Act to include dealing with appeals against a withdrawal of authorisation, but not for appeals regarding fit and proper assessments.) The regulations should therefore include a process for appeal.

4. Are there any significant practical barriers to schemes meeting these requirements?

20. We are not aware of any significant practical barriers.

5. Are there any significant practical issues for Master Trust schemes in providing the information required for the business plan?

21. We are not aware of any significant practical issues.

6. How can we improve the clarity, coherence and comprehensibility of the list of information to be included in the Business Plan across the spectrum of scheme models?

22. Each application will need to be considered on its own merits in context, taking account of the scheme's particular circumstances. It is therefore not beneficial to be overly prescriptive in the regulations about what should be required in relation to business plans as it is not possible to anticipate all possible scenarios or scheme operating models. See also our comment at paragraph 43 below regarding omissions from Schedule 3 (ie it makes no reference to investment arrangements).

7. Should the detailed requirements in relation to the business plan be set out in code of practice rather than regulations?

23. Yes. As we mention above, each application will need to be considered on its own merits in context, taking account of the scheme's particular circumstances. It is therefore not beneficial to be overly prescriptive in the regulations about what should be required in relation to business plans. These requirements should instead be included in the underlying Code, so that it can be more flexible and better able to keep pace with developments. For example, three years ago, how many scheme business plans would have provided for a Brexit scenario.

8. What, if any, other lines of business do scheme funders carry out that do not undermine the transparency of their financial arrangement with the scheme?

24. We are not in a position to answer this question, which Funders will be better placed to answer as the answer will depend upon the circumstances and structure of any given scheme and its respective Funder(s), and what businesses are carried out within that group.

9. What, if any, disclosures of the matters in regulation 7 [*sic,* should be regulation 8], scheme funder requirements would be disproportionate to provide and why?

25. We are not in a position to answer this question, which Funders will be better placed to answer.

10. What, if any, alternatives could we consider to make the scheme funder's financial arrangements with the Master Trust sufficiently transparent to the regulator for its financial assessment?

26. This will depend on the circumstances and constitution/structure/corporate form of the Funder, and the arrangements between the Funder and the scheme. In our view, all financial arrangements between the Funder and the scheme should be entirely transparent to TPR and so, given there is no prescribed relationship between Funder and scheme (meaning it is not possible to be overly prescriptive), the regulations should instead provide that there should be

full disclosure of anything relevant to the financial arrangements between the Funder and the scheme.

11. Are there any circumstances where scheme funders would not be able to comply with the requirement to submit their accounts no later than nine months after the end of the financial year to which they relate and if so why?

27. We are not aware of any such circumstances.

ADDITIONAL VIEWS ON THE PROPOSALS SET OUT IN THE CONSULTATION

Proposed fees

28. Paragraphs 38-43 (Regulation 4(4)): We query in principle the DWP's proposal that existing schemes will be subject to greater authorisation fees than new schemes. Existing schemes will have already been subject to set up costs, restructuring costs (in order to comply with the new regime), and many have also incurred costs in assisting the Regulator and DWP in devising the new regime (including management time and professional fees).

Scheme funder requirements: independent review of their accounts

29. Paragraph 56 (Regulation 9(3)): See our comments at paragraphs 1-7 above.

Systems and processes

30. Paragraphs 59 to 61 (Regulation 10 *Systems and processes requirements, and Schedule 4*): Schedule 4 contains a lot of detailed requirements that should be moved into the underlying Code in order to avoid the regulations being inflexible and unable to move with the times. For instance, these requirements will need to be kept under constant review to keep pace with developments in technology, cyber security threats etc. The Schedule also currently doesn't include any control measures (although Paragraph 61 appears to provide that those would be contained in the underlying Code). The measures are also incomplete, for example, they do not include any requirements in relation to financial record keeping, custody and safekeeping of investments and investment platforms and structures. We would welcome the opportunity to work with you as to how the underlying Code could apply 'assurance mapping' of the systems and processes requirements to determine to what extent and breadth the trustees of master trusts require information to satisfy themselves that the correct level of assurance is being obtained.

31. As we mention at paragraph 8 above, we would be happy to work with the DWP and TPR to develop their list of requirements, as this could build on the work we have already done in developing the Master Trust Assurance Framework with TPR, which has been adopted by many of the leading master trusts. That framework provides valuable assurance about the top level governance controls that trustees need to put in place including trustee oversight of the types of systems and processes carried out on their behalf referred to in Schedule 4 to the draft regulations, rather than providing assurance over the underlying systems and processes themselves. However, we are happy to work with you to see how the MTAF could be refined and/or to look at alternative sources of information to provide to TPR. However, we note there would be an additional cost for schemes in making this kind of detailed information available to TPR.

32. We note the wording in Regulation 10 mirrors that in s11 of the Pension Schemes Act 2017, which is very onerous in that it requires TPR to decide whether it is satisfied that the systems and processes used in running the scheme <u>are sufficient to ensure that it is run effectively</u> (similarly, the drafting of Regulation 5(3)(d) is also onerous). We note that the Pension Schemes Act 2017 passed through Parliament without the normal level of scrutiny, as the committee stage debate was initially prevented by the Westminster terror attacks, and scope for committee stage debate was also restricted due to the snap election. Section 11 is one of the sections within the Pension Schemes Act 2017 that may well have benefited from more

thorough Parliamentary scrutiny, but this may need primary legislation to be appropriately addressed. We further note that ss(3) refers to IT systems ((which is undefined but we would assume refers to Information Technology systems) and the standards that those IT systems must meet for example, in relation to quality and security of data), which is unusually detailed for primary legislation and again would have benefited from more thorough scrutiny. The lack of a definition also makes it very difficult to assess what is and is not part of the IT system, and to what extent a master trust can be held accountable for “ineffectiveness” for late contributions and late investments due to an employer sending member contributions with inaccurate data.

Fraud compensation

33. Paragraph 97 (Regulation 23): We welcome the clarification that Master Trusts can benefit from the fraud compensation regime under the Pensions Act 2004.

ADDITIONAL VIEWS ON THE DRAFT REGULATIONS IN ANNEX A

Scheme funder requirements: accounts

34. Regulation 9 *Scheme funder requirements: accounts*: It would be clearer if this regulation stated that the Funder must prepare full Companies Act accounts without applying any of the listed exemptions (otherwise, as currently drafted, it is not clear which accounts the regulation is referring to).

35. Regulation 9(4)(b) allows monies held on account in lieu of audited accounts to be released on the day those accounts are provided to TPR. However, this does not build in any test of what material is in those accounts or any review period for TPR. It might not be appropriate for the monies to be released if for example the accounts have a going concern qualification.

36. See also our comments at paragraphs 1-7 above in relation to Regulation 9(3)).

Ear-marked schemes

37. Regulation 13(c) is incorrect as it states that the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations 1996 require ear-marked schemes to obtain audited accounts (whereas these regulations provide an exemption for ear-marked schemes).

38. As we mention at paragraph 13] above, the ICAEW also considers the governance regime for Master Trusts that are ‘ear-marked schemes' needs to be reviewed with a view to abolishing the audit exemption for those ‘ear-marked schemes' that are Master Trusts. This could be achieved by amending the audited accounts regulations (1996/1975) so that this exemption would only be available for ear-marked schemes that are not master trusts. Furthermore, we note that respondents to the FRC’s consultation on the revision of PN 15 raised concerns over the interpretation of the definition of ear-marked schemes, suggesting that even though they have been around for many years there is still a risk that schemes which were not intended to be covered by the audit exemption are taking advantage of it.

39. We also note that the audit requirements for all ‘ear-marked schemes' with 20 or more participating employers are causing issues in practice. By way of background, these ‘light touch’ schemes were given an audit exemption in the mid-90s in the wake of the increased regulation after Maxwell (on the basis that they were low risk as backed by an insurance policy). These schemes were therefore exempted from including audited accounts in their annual report (their trustees were instead required to provide on request a copy of the latest published accounts of the insurance company with which they hold the ear-marked policies of insurance or annuity contracts). The trustees were still required to appoint an auditor to the earmarked scheme to provide a statement about contributions for inclusion in the annual report of the scheme. However, there is now a general exemption from auditors’ statements on contributions for any

scheme with 20 or more participating employers, so ear-marked schemes with 20 or more participating employers still have a continuing requirement for an auditor to be appointed but it is not clear whether auditors are even able to accept appointments in those cases as there is nothing for the auditor to do, and so this can cause issues for our members as well as for trustees who are still obliged to appoint auditors for such schemes.

Loans provided to the scheme

40. Schedule 2 paragraph 1(e) refers to loans provided to the scheme (requiring TPR to take account of "*the terms, security and affordability of loans and other funding provided to the scheme, and the identity of each associated lender*"). However, we note that regulation 5 of the Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378) reads:

"5 Borrowing and guarantees by trustees

(1) Except as provided in paragraph (2), the trustees of a trust scheme, and a fund manager to whom any discretion has been delegated under section 34 of the 1995 Act, must not borrow money or act as a guarantor in respect of the obligations of another person where the borrowing is liable to be repaid, or liability under a guarantee is liable to be satisfied, out of the assets of the scheme.
(2) Paragraph (1) does not preclude borrowing made only for the purpose of providing liquidity for the scheme and on a temporary basis."

41. We therefore consider that the wording of Schedule 2 paragraph 1 could be misleading, and should instead be made consistent with the wording of the Investment Regulations.

42. If the intention is that Schedule 2 paragraph 1(e) refers to financing provided to the Funder rather than to the scheme, this needs to be made clear in the regulations.

Business plan

43. We note that Schedule 3 makes no reference to investment arrangements.

44. We note that paragraph 42 of Schedule 3 refers to "*the profit or loss which the scheme's commercial operations are expected to yield for each year of the plan period, and by whom the profit or loss will be realised*". References to commercial operations within pension schemes could jeopardise tax reliefs. If the intention is that Schedule 3 paragraph 42 refers to the Funder's profit objective rather than that of the scheme, this needs to be made clear in the regulations.