THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

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Our ref: ICAEW Rep 59/07

Your ref:

Louise Robinson
The Pensions Regulator
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By email to govpaper@thepensionsregulator.gsi.gov.uk

Dear Ms Robinson

**THE GOVERNANCE OF WORK-BASED PENSION SCHEMES**

The Institute of Chartered Accountants in England and Wales ('the Institute') is pleased to respond to your request for comments on the discussion paper *The governance of work-based pension schemes*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

# ICAEW Representation

**ICAEW REP 59/07**

**THE GOVERNANCE OF WORK-BASED PENSION SCHEMES**

**Memorandum of comment submitted in July 2007 by The Institute of Chartered Accountants in England and Wales, in response to the Pensions Regulator discussion paper '*The governance of work-based pension schemes* published in April 2007'.**

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## INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the discussion paper *The governance of work-based pension schemes* published by the Pensions Regulator.

## WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 128,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

## GENERAL POINTS

4. We welcome the proposals in the discussion paper, especially the paragraphs aimed at smaller schemes, and we think the case study examples provide useful practical guidance for trustees.

5. We think it would be useful if, going forward, the illustrations of trustee attitudes, such as the table at Figure 4, were to be updated to include statistics from the annual surveys (and comparatives to illustrate trends). We also think the case studies should be updated and expanded where appropriate, based on evidence gathered.

6. We support the cross-references to other sources (e.g. footnote 22 to paragraph 9.12 refers to the Model Administration Agreement published by the Pensions Management Institute (PMI)) but we think it would be useful to have an appendix listing other useful references or links for information and guidance. The list could include Codes of Practice (CP) such as CP07, *Trustee Knowledge and Understanding*, National Association of Pension Funds (NAPF) materials, Institute publications such as the Ethical Helpsheet on conflicts of interest and AAF 1/06 *Assurance reports on internal controls made available to third parties*, the ethical standards issued by the Auditing Practices Board, and Pensions Management Institute materials and qualifications.

## RESPONSES TO SPECIFIC QUESTIONS

***Q1: Is the Pensions Regulator right to place importance on the governance of pension schemes?***

7. Yes.

***Q2: Do you agree with the determinants of our regulatory priorities set out in paragraph 3.7? These are:***

- ***the regulator's existing approaches to governance;***
- ***evidence of how schemes are governed;***
- ***recent and forthcoming developments in the pensions environment; and***
- ***our approach to regulation.***

8. Yes, although we think it might be helpful to mention the statutory underpin, and see also our comment below regarding the table illustrating these priorities, which we think should address some issues around annuities.

***Q3 Do you agree with our regulatory priorities? [These are:]***

***Knowledge and understanding of the governing body***

***1. Knowledge and understanding***

***Relationships of the governing body***

***2. Conflicts of interest***

***3. Monitoring of employer covenant***

***4. Relations with advisers***

***Procedures of the governing body***

***5. Administration***

***6. Processes for investment choice***

***7. Governance during wind-up***

9. Yes, although we think it would be helpful if the statement were to mention that good internal controls underpin most or all of the listed priorities.

***Q4 Are there particular points you wish to make about any of the priorities?***

10. We consider that it would be useful to expand the advisers section to include other third parties such as administration service providers and insurers.

    We are aware that the Regulator is looking at DC arrangements, and we wish to stress that the importance of administrative procedures and controls cannot be overemphasised.

***Q5 Do you have suggestions for how these priorities should be addressed for smaller schemes?***

11. Many small schemes are not very well-run. Small defined benefit schemes, which are usually insured, have an actuary who will ensure that a valuation takes place and auditors will assist the trustees in fulfilling the duty to obtain

annual audited accounts. However, contact with advisers is often minimal and trustees may have meetings infrequently.

In the case of small DC schemes, it is evident that a number of trustees do not monitor contributions nor reconcile membership data on a regular basis. Again, trustees may have very infrequent meetings and some seem to have none at all.

We suggest therefore that the Regulator produce guidance on running a small scheme with a list of action points. Some years ago, the Pensions Research Accountants Group produced a checklist of controls for small schemes and this could be a useful starting point.

***Q6 Do you agree with our analysis of contract-based schemes, and the new proposals we are considering on:***

- ***providing examples of employer-led 'management committees'?***
- ***guidance providing questions to ask on commission and fees?***
- ***administration?***
- ***investment processes?***

12. We broadly agree with the comments, but would like to see the inclusion of options on retirement and purchases of annuities in the administration and investment processes

## Other comments

13. Page 11 - Protecting member benefits

    We think it would be useful if these paragraphs also considered the employer's role, especially in DC schemes, in relation to payroll deductions.

14. Page 14 – table illustrating 'Impact of recent and future issues on governance'

    We think the table should cover the whole 'lifecycle' of a fund. In particular, it does not currently set out some of the issues that arise at the point when the fund is providing a pension, such as the acquisition of annuities, selection of annuity provider, inflation linking etc.

15. Chapter 6 – Conflicts of Interest

    The Institute's 2006 Pensions Monitor identified actual or potential conflicts of interest where individuals perform the dual role of both Trustee and member of the Board, particularly in companies offering Final Salary pension schemes. Conflict relates mainly to funding issues, including increases in employer and employee contributions, and improving benefits for members. The research report noted that only a minority of companies have introduced confidentiality agreements for individuals or all Board members, and a small number simply do not appoint Board members as Trustees. In 6 out of 10 instances where actual or potential conflict is identified, no action has been taken at all to mitigate any such conflict. The Institute Ethical Helpsheet on conflicts of interest addresses some of these issues and we recommend that it be referred to, either by way of foot note, or by inclusion in a list of useful reference material in an appendix to the proposed guidance.

16. Chapter 8 - Relations with advisers

We think it is unhelpful to refer to scheme auditors in this section (for instance, in paragraph 8.2). Although auditors are categorised as 'advisers' in legislation for the purposes of whistleblowing, for example, their duties are very specific, and relate to expressing an independent opinion on scheme financial statements and related information. The Code of Ethics to which auditors are subject requires them to take steps to safeguard their independence and objectivity and, where threats cannot be addressed, they may not undertake or continue with an engagement. The risk envisaged in paragraph 8.3 is therefore irrelevant to audit. Auditors may give information (as opposed to advice) to the trustees but the risk of harm to scheme interests because that information is misunderstood by the trustees (8.4) is remote.

17. Chapter 9 – Administration

This chapter should give more emphasis to the importance of good administration, especially for DC schemes, which should be run as if in wind up, with record keeping up to date etc. The evidence in paragraphs 9.2 *et seq* make it clear that a significant number of schemes are not currently doing this – possibly these are trustees of schemes that were previously DB schemes where the need for ringfencing, and the need for contributions to be invested on time, is less of a risk to member benefits. We also think it should mention misallocation (ie failures in ringfencing), failure to implement lifestyling, and failure to implement investment choices as risks to DC schemes (and member benefits) – see paragraphs 9.6-9.8. It should also mention the cost of rectification for administration failures, especially where the Third Party Administrator has become insolvent. We think it would be helpful if the Regulator's guidance mentioned (and recommended) assurance reports such as those given under the Institute publication AAF 1/06 (see paragraph 6 above).

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