NEST Corporation's response to ICAEW Consultation on Assurance Reporting on Master Trusts

Introduction

The NEST pension scheme falls within the definition of 'master trust' articulated by the Pensions Regulator (TPR) in their 'Strategy for regulating defined contribution pension schemes' published in October 2013. Consequently, we are assuming that TPR's view that trustees of master trusts would 'find it beneficial to prepare the report outlined in this consultation and have it independently assurance checked by a reporting accountant', applies to NEST Corporation, the trustee of NEST. We are therefore pleased to have the opportunity to respond to this consultation.

We welcome the steps currently being taken by the Government and regulators to promote better outcomes for consumers in the workplace pensions market. We do have concerns however about the coherence of the various initiatives. It would be welcome and reassuring if one body could co-ordinate and have oversight of the range of initiatives in this area to ensure that everything fits together as it should and there is no duplication, overlap or inconsistency. Our preference would be, ultimately, for the ability to evidence compliance with a particular assurance framework – such as this one – to serve as evidence of compliance with all relevant codes, guidance and obligations (such as the provision of a governance statement) in the areas covered by that framework. At the same time it is important to recognise that it is impossible to remove all risks from pension schemes and this should not be the aim of a particular framework or series of initiatives. Risks can be managed but they can't – and often shouldn't – be completely eliminated.

Against this background, we are supportive of an independently assured quality bar for defined contribution (DC) schemes and achieving this for master trusts is a sensible place to start. We strongly advocate ultimately extending the framework to cover all DC schemes[1] and, as currently designed (drawing on all of the DC quality features, bar four), the framework (with a few exceptions where control objectives are not sufficiently clear or too subjective) would work well with such coverage. This would create a level playing field and recognise that some of the risks TPR has identified re. master trusts, such as conflicts of interest where there is an administrative or investment tie to a particular provider, are inherent to the same degree, or more so, in contract-based arrangements.

In the meantime, while coverage is restricted to master trusts, a more narrow set of control objectives, aimed at addressing the specific risks which TPR believes master trusts present, would be appropriate. This would ensure the framework is proportionate in the early days and not too onerous at a time when master trust resource will be stretched as large numbers of employers reach their staging dates. This would also be in line with TPR's proposal in their Defined Contribution response[2] that in order to reduce the overall cost of independent assurance, they could 'focus control objectives (used by auditors) on those DC quality features that address inherent risks in master trusts, for example those related to business/commercial risks and conflicts of interest.'

[1] Including contract-based schemes

[2] DC consultation response, July 2013, TPR

It would be helpful therefore if TPR could articulate in further detail what they think the risks inherent in master trusts are, so the proposed control objectives can be narrowed down to those that address those risks (for the time being). While TPR has given some indication of this – referring to 'commercial/business risks, conflicts of interest, low barriers to entry and the commercial interests driving some master trusts' in their Defined Contribution response – these risks have not been articulated in any detail.

An alternative to narrowing down the set of control objectives in this way – and one which would cater for the fact that there are wide variations between master trusts as a class – would be for trustees of master trusts to carry out their own risk assessment to determine the key risks for their scheme and then seek independent assurance of only the control objectives that relate to those risks.

In order to ensure value for money for members (who will ultimately be paying for this assurance – certainly in the case of NEST), as well as ensuring the framework is proportionate and targeted on the right risks – or trustees implement it in a way that ensures a focus on the risks specific to their scheme – it may make sense to require the independent assurance say every three years, with Internal Audit carrying out the reviews in the interim. This is one respect in which the approach could be tailored in a risk-based way, with classes of schemes presenting greater risk being subject to a requirement for more frequent independent assurance.

Finally, we would suggest that the articulation of many of the control objectives would benefit from some further refinement. We understand that a proposal to set up a working group of practitioners to further refine the control objectives to ensure the assurance assessment can be objectively carried out, is likely to be forthcoming, and would be very supportive of such an initiative.

Responses to questions raised in the consultation

Question 1 – Are the control objectives set out in this Supplement appropriate and relevant? If not, what are the obstacles? Is the linkage to the Regulator's DC quality features useful in setting the context for the control objectives?

As mentioned above, we recommend that this control framework ultimately be applied to all DC schemes, in which case these control objectives, in the main, seem to be appropriate and relevant as they cover most of the risks inherent in DC schemes generally. However, in the interim, while the framework applies to master trusts only, the framework is too wide and not sufficiently focussed on the risks inherent in master trusts. This could be addressed by seeking an articulation from TPR of the risks they think are inherent in master trusts and then narrowing the set of control objectives down to the ones that address those risks. Alternatively, a wide framework could be retained with trustees identifying the risks specific to their scheme and seeking independent assurance re. the specific control objectives related to those risks. The latter approach would cater for the fact that master trusts take different forms and present different risks and cannot easily be regulated via a 'one size fits all approach'.

We note that there are a number of control objectives which relate to risks which are also addressed in other TPR guidance and Codes of Practice. Including these in control objectives creates a risk that over time, consistency between the control objectives and the guidance and codes could be compromised. This will need to be managed.

As noted in the responses below, there are also some control objectives which we think may be too subjective to be independently assured and some for which further clarification would be helpful.

Question 2 – Are the control objectives relevant to governance activities in Master Trusts? Are there any other control objectives that should be added to address key risks inherent in master trusts?

The control objectives are relevant to governance activities in Master Trusts – but see comments above re. extension to other DC schemes and tailoring to master trust risks in the meantime.

As the proposed framework already has more control objectives than analogous frameworks such as the third party assurance frameworks in AAF01/06, we would not advocate adding more.

Question 3 – In the discussion document we identify four of the Regulator's DC quality features that are not included in the list of controls included in Appendix 1 on the basis that they are too subjective to be practically audited. Do you agree with this or do you think that they can and should be incorporated in the list of control objectives?

We think it would be possible to articulate some control objectives around these quality features in a way which would allow for objective assurance checking. As discussed in the 'introduction' we would support the setting up of a working group of practitioners to refine the control objectives. This group could potentially also work up some control objectives around these quality features. Examples of control objectives which are currently drafted too subjectively, and would benefit from examination by a working group are:

- Some of the objectives around communications – in particular the assessment of the suitability of a plan for member communication. The suitability of such a plan cannot be assessed on a 'one size fits all' basis. The suitability of a plan will depend on various factors including the aims of the scheme and the level of engagement and sophistication of its members. It would be inappropriate to assess the plans of a scheme with an engaged, sophisticated membership on the same criteria as one with an unengaged membership.
- The control objectives relating to assessing whether the master trust represents value for money. This is quite a subjective area because it isn't just about cost and requires the exercise of judgement. Judging whether a pension scheme is good value will require consideration of the governance, communications, investment strategy and administration/service offered by the scheme as well as the charges.

Question 4 – Is the guidance in the Supplement clearly drafted for (i) trustees of Master Trusts, and (ii) practitioners? If not, what further explanation should we provide?

(i) More clarity would be helpful around the following control objective:

- Disclosure of charges. The exact wording of this control objective should be driven by the outcome of DWP's consultation on charges. However, in any event, we would advocate far less prescription in this objective. The objective should be defined by reference to outcomes and it should be for the master trust trustee to decide, in line with their fiduciary duty to act in members' interests, how best to achieve those outcomes – and to be able to evidence that. In the absence of this, we would need further detail – including a definition of charges and an explanation of how certain charges are to be calculated in certain circumstances (e.g. if the AMC is taken daily and reflected in the fund price, how should this be disclosed in £ and p) and an explanation of the level of accuracy required in the £ disclosure (e.g. to nearest penny?) – to ascertain if we could comply with these requirements. It should also be noted that a number of voluntary Codes have recently been developed by trade bodies (the NAPF, ABI and IMA) with the aim of addressing this issue. All take a slightly different approach to defining charges and articulating just what should be disclosed. If ICAEW/TPR and DWP also take different approaches, this will lead to a very confusing picture.

Question 5 – The independent assurance framework will provide a tool to help trustees of Master Trusts demonstrate and evidence the presence of DC quality features as well as obtain reasonable assurance that the underlying control procedures that underpin these features are operationally effective. Do you therefore agree that the assurance opinion should cover the description, design and operating effectiveness of the internal controls relating to the specific Master Trust activities, as suggested in the Exposure Draft?

Yes, we agree that the assurance opinion should cover the description, design and operating effectiveness of the internal controls relating to the specific Master Trust activities, as suggested. This appears to align with how other assurance frameworks operate.

Question 6 – How might other industry pension standards (such as NAPF's pensions quality mark for master trusts) and assurance frameworks be co-ordinated with the assurance framework provided in this supplement?

We think this framework should have regard to other industry pension standards such as the PQM Ready mark and explain the extent to which meeting those standards can provide evidence of compliance with the control objectives, as appropriate. This would align with the recent TPR guidance for DC schemes which highlights relevant codes and standards, as appropriate.

It will also be important for this framework to be consistent with – and keep up with any changes to – any standards introduced by DWP and others. For example, the DWP are currently consulting on charges. Their consultation considers both introducing standards around the disclosure of charges and/or introducing a charge cap. Any control objectives around the disclosure of charges will therefore need to align with the approach DWP ultimately takes on this. For example, if DWP conclude that standards around the disclosure of charges are not necessary because they are e.g. unlikely to be effective and because they are going to introduce a charge cap, the assurance framework should align with that decision. Similarly, a power has been introduced into the Pensions Bill 2013 which would allow the Secretary of State to introduce (via regulations) administration or governance requirements on work-based pension schemes. This framework will need to develop in line with the introduction of any such standards.

Question 7 – The control objectives in Appendix 1 are intended to apply to Master Trusts of all sizes. Are there any perceived barriers to implementing the expected controls, for example, do providers foresee difficulties providing documentary evidence to support the assurance conclusions? Do practitioners envisage practical difficulties in proving assurance on any of the control objectives?

As mentioned in the 'Introduction' section of this response, there are wide variations between master trusts and the potential nature of the risks to members varies within the sector. It is therefore arguably inappropriate to seek to apply a 'one size fits all' approach to this sector.

As far as barriers to implementing some of the expected controls are concerned, we would find the following specific control objectives potentially problematic:

- Data quality – Like other providers of automatic enrolment schemes, we have to rely on the employer to provide us with accurate data about the member (enrolment information). However, although the employer has a legal obligation to provide accurate enrolment information, they do not always do so. Unlike other providers, due to our public service obligation to accept all employers who want to use NEST to meet their duties, it is difficult for us to refuse to deal with employers who consistently provide us with inaccurate data. We thereafter rely on members to tell us if their data changes, but we have no means of enforcing this (although we do put an obligation in our employer terms and conditions to the effect that, where they become aware of a change, the employer should prompt the member to tell us).

- Those relating to the disclosure of costs and charges. The exact wording of this control objective should be driven by the outcome of DWP's consultation on charges. However, in any event, we would advocate far less prescription in this objective. The objective should be defined by reference to outcomes and it should be for the master trust trustee to decide, in line with their fiduciary duty to act in members' interests, how best to achieve those outcomes – and to be able to evidence that. In the absence of this, we would need further detail – including a definition of charges and an explanation of how certain charges are to be calculated in certain circumstances (e.g. if the AMC is taken daily and reflected in the fund price, how should this be disclosed in £ and p) and an explanation of the level of accuracy required in the £ disclosure (e.g. to nearest penny?) – to ascertain if we could comply with these requirements. It should also be noted that a number of voluntary Codes have recently been developed by trade bodies (the NAPF, ABI and IMA) with the aim of addressing this issue. All take a slightly different approach to defining charges and articulating just what should be disclosed. If ICAEW/TPR and DWP also take different approaches, this will lead to a very confusing picture.

Question 8 – Do you agree that the proposed transitional arrangements are adequate?

We suggest that in the early years of carrying out this assurance checking, trustees should have the opportunity to address any gaps in evidence identified by the process, before publishing the report. This is in order to provide assurance to employers – which we understand is the main purpose of this framework. We are concerned that, if trustees are not given this opportunity, employers may become unduly concerned about the quality of the scheme they are proposing to use when actually there may be nothing wrong with the scheme – it may just be that the trustees weren't able to evidence a particular control. If trustees have the opportunity to address this before publishing the report, the necessary assurance that this has now been addressed can be provided to employers.

As mentioned in the 'introduction' section, we would support the setting up of a working group of practitioners to further refine the control objectives. Depending on how quickly this work could be carried out, this may necessitate a small delay to the introduction of the framework.

Question 9 – Are there any other issues related to the assurance framework for Master Trusts that you think we should consider?

Some comments on specific control objectives which would be worth considering are:

CO#5 – New business. NEST Corporation has a public service obligation to allow any employer who wishes to use NEST to meet their employer duties, to do so. Therefore, we cannot turn down new business on the grounds of insufficient capacity. This control objective should therefore cater for a situation like NEST Corporation's where something like an annual assessment of capacity might be more appropriate.

CO#11 – compensation agreements. The consultation appears to conflate compensation for investment loss with compensation for losses due to insolvency – thus demonstrating the complicated nature of this topic. If the scheme is invested in insured funds then there is some compensation available from the financial services compensation scheme (FSCS) if the insurance company becomes insolvent – other insolvency losses are not covered for occupational DC schemes. Investment losses are not covered by the FSCS. In any event members are not eligible claimants under the FSCS and the Trustee would have to claim on their behalf the position is complex and care will need to be taken in communicating it to members.

CO#32 and 34 – contract management. These control objectives do not recognise the fact that some contracts will be higher risk than others and so require a greater degree of management/additional controls than other, lower risk contracts. A 'one size fits all' approach – as seems to be envisaged in the control objectives, is not appropriate. We therefore recommend that these control objectives be amended to recognise that it may be appropriate to carry out some form of risk profiling of contracts and adopt differing approaches based on the outcome of that.

CO#33 – this control objective does not directly address purchasing and routes to market. For example public sector bodies such as NEST Corporation are subject to public procurement rules. ICAEW may wish to consider if this should be addressed in the control objectives.

CO#35 – we suggest that control objective 35 could be clearer. It currently reads:

'Risks are identified and evaluated and recorded in a risk register together with internal controls and mitigations of significant operational, financial, regulatory and compliance risks identified by the trustees. This is reviewed and updated at least annually.'

The following might be a clearer articulation:

'Trustees should identify risks, including significant operational, financial, regulatory and compliance risks. These risks should be evaluated for impact and likelihood and appropriate mitigating actions should be identified and implemented as relevant. A risk register containing this information should be created, and should be reviewed and updated on at least annually.'

CO#37 – as drafted ('fully fund the cost of administrative errors') this doesn't take account of extremely unlikely but high cost scenarios that potentially impose high insurance costs on schemes. A better wording would be something like 'Trustees have arrangements in place to fully fund the cost of administrative errors that might reasonably be expected to impact on member benefits'.

CO#38 – refers to 5 working days. This is onerous by comparison as other assurance frameworks say in a timely manner.