Pensions accounting, assurance & regulatory round-up

Private sector occupational pension schemes

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Autumn 2017

Introduction

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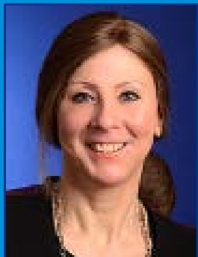

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Welcome to the Autumn 2017 edition of Pensions Accounting, Assurance & Regulatory Round-Up for private sector occupational pension schemes.

In this edition we bring you an update on the activities of The Pensions Regulator as we see the watchdog's expectations for trustees and their standards of stewardship continually rise. We have received further guidance on VAT on investment management fees and HMRC have recently released a brief covering the provision of certain pension fund management services by regulated insurance companies. In addition we pick up a few key themes which will carry us into 2018 where we can expect further challenge and additional regulation.

If you have any queries or would like to discuss any of the matters herein further, please do get in touch with your usual contact at KPMG, Anne or Sarah, or email us at:

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The Pensions Regulator - Update and recent activities

We have refined our priorities from last year's plan so they are clearer and more specific about our intentions, and enable us to continue to meet our statutory objective in the changing landscape .

Source: TPR

Since the Spring Edition, we have seen a continued stream of communications and guidance from The Pensions Regulator (TPR) and recent announcements suggest a raising of the bar of what it expects from trustees and employers. In this Edition of Round-Up we pick up the key themes of TPR's corporate priorities and highlight steps taken to date.

In April 2017, TPR published its Corporate Plan for 2017 – 2020 in which it announced it would continue to shift the focus of its resourcing to frontline regulatory activity, acting faster and intervening more frequently to drive positive outcomes. Amongst key themes driving TPR's priorities include sub-scale schemes; poor standards of stewardship; disorderly scheme failures; poor data integrity and security and the general economic and market outlook. From TPR's assessment of the evolving pensions landscape and the risks faced by the pensions industry, eight corporate priorities have been developed:

— Successfully complete the remaining stages of the roll-out of auto-enrolment;

— Deliver more interventions more quickly where defined benefit schemes are under-funded or avoidance is suspected;

— Protect consumers through the effective regulation of master trusts – developing a code of practice and supporting guidance against the backdrop of the new requirements of the Pension Schemes Act 2017;

— Drive up standards of record-keeping and data maintenance, including public service schemes;

— Be clearer in codes, guidance and other interactions with schemes and employers about what they need to do;

— Drive up standards of trusteeship across all schemes, with a particular focus on chairs and professional trustees;

— Develop and implement an enhanced approach to regulation, explaining the approach publicly, making TPR a more effective and efficient regulator; and

— Create high performing teams of people across TPR with the skills and capabilities to deliver all of the above.

Deliver more interventions more quickly where defined benefit schemes are under-funded or avoidance is suspected

Public awareness of pensions is now high, largely as a result of auto-enrolment and media interest in a small number of cases involving household name employers' defined benefit schemes. TPR has committed itself to acting faster and more often where DB schemes are underfunded or where avoidance is suspected. Only 15% of the total DB schemes are still open and although 80% of DB schemes have less than 1,000 members, in total these schemes hold £130 billion in assets. (SOURCE: TPR Corporate Plan April 2017).

Recently at the PLSA Annual Conference, Leslie Titcomb confirmed that TPR had used its powers under section 231 of the Pensions Act 2004 to issue a warning to an undisclosed scheme. Under section 231 The Regulator can impose a contributions schedule on an employer if it is not happy with the schedule agreed between the employer and the trustee.

TPR has already indicated it would like new powers, including in respect of scheme funding.

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The Pensions Regulator - Update and recent activities (cont.)

Additional data information now required on scheme returns

Drive up standards of record-keeping and data maintenance, including public service schemes

TPR has announced that it will be asking schemes to submit information around data as part of the annual scheme return. In addition, 'conditional data' is going to be renamed as 'scheme-specific data'. From 2018 (January for defined benefit schemes and summer for defined contribution schemes) schemes will need to report their common and scheme –specific scores in the annual return, together with the data score for the scheme and details of when the last data review was carried out. The data score is the percentage of members for which the scheme has full and accurate common and scheme – specific data. Look out for a new publication 'Quick Guide to Measuring Data' which will be on TPR's website sometime in November.

Drive up standards of trusteeship across all schemes, with a particular focus on chairs and professional trustees

Following the Consultation on monetary policies and the description of a professional trustee, TPR has issued its final guidance.

Monetary Policy: According to the degree of severity, each breach will be assigned to one of three bands, with the maximum fine set at £50,000. The Policy is based on three main principles: the penalty should be proportionate to the breach; the amount should aim to change the behaviour of the person in breach; and the penalty should aim to deter repetition of the breach among the wider regulated community. TPR make particular reference to the breaches of the requirement to produce an annual chair's statement and the failure to submit an annual return on time.

Professional Trustee Description: Following the Consultation responses, TPR have clarified its definition which is now based solely on whether a person is acting as a trustee of a scheme in the course of the business of being a trustee. Where an individual represents/promotes themselves as having expertise in trustee matters generally, TPR would normally consider them to be acting in the course of business of being a trustee. The guidance continues The Regulator's drive to improve standards of trusteeship and governance. The Professional Trustee Standards Working Group, formed in July from a number of industry groups, are working to develop higher standards – 'fit and proper protocols' for professional trustees. These will cover competencies and experience, acknowledging different requirements will apply to chairs, non-chairs and sole trusteeships.

'Protecting workplace pensions' TPR Future – a review of the way we work

In July 2017, The Regulator published 'TPR Future' providing an update on its review of the way it works. TPR Future first featured in 2016 when TPR engaged with stakeholders to look at risks and challenges to create a sustainable approach to regulation. The review had been a part of the Corporate Plan published earlier in the year and its aim was to assess the effectiveness of its current approach and operating model. The review covered changes and challenges faced over the 12 years since TPR was set up, and involved input from a broad range of external stakeholders as well as The Regulator's own internal teams.

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The Pensions Regulator - Update and recent activities (cont.)

The Pensions Regulator welcomes the development of tools like this, which provide ways for trustees to assess their current levels of governance and set targets for improvement. As part of our work on 21st Century Trusteeship we would like to encourage trustees to regularly assess their board effectiveness and we welcome initiatives developed by industry to support TPR s drive to improve governance.

Lesley Titcomb,
Chief Executive, TPR on the Trustee Effectiveness Service (PLSA)

The main recommendations from the review were grouped into six key areas:

- External representation.
- TPR's identity.
- Broadening regulatory approaches.
- Exercising its powers.
- Improving regulatory activity.
- Evolving the operating model.

TPR had already begun making changes for example increased fines imposed and assistance with breaking the deadlock between trustees and employers in a funding and restricting case. TPR has already secured its first criminal convictions for not providing requested information. The next update is due Spring 2018, but look out for forthcoming thematic reviews.

Governance and improving standards of stewardship

Improving standards of governance and the drive to raise standards of stewardship as set out in the 21st century trustee initiative remain key focal points for The Regulator, ensuring schemes are compliant with their basic duties. Research was carried out in Spring 2017 for DB and DC schemes to understand the extent schemes met expectations set out in TPR's Codes of Practice and Regulatory Guidance. Results revealed that although some improvements had been made, many defined benefit schemes have poor integrated risk management (IRM) practices. Many small and medium defined contribution schemes are not meeting standards around administration, investments and value for member assessments. Two compliance and enforcement bulletins issued in July confirmed s173 fines to schemes and trustees during 2016 as a result of failures to prepare annual governance statements or complete the annual scheme returns. TPR adopted a 'zero tolerance approach' to the non-completion of scheme returns as it was seen that not complying with the basics could indicate wider governance issues.

A report by Sackers and Winmark found that 65% of schemes are spending more time on governance than three years ago. The report, Effective Governance – the Art of Balance was based on a survey of 84 pension schemes, and 13 in-depth interviews with chairs of trustees and other pensions experts. The report looked at governance challenges faced by the trustees and their priorities, relationships between good governance and scheme effectiveness, member benefits and employer interests; the impact of rising governance standards on the trustee workload and practical recommendations to improve standards and effectiveness. A key message from the report was that governance should never be a tick-box exercise. Compliance is important, but not the primary focus of governance and that too much time spent on governance could detract from other governance priorities that lead to good member outcomes.

The Pensions & Lifetime Savings Association, in collaboration with KPMG, have launched a Trustee Effectiveness Service to help trustees review their governance and check how it measures up to The Regulator's expectations.

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The Pensions Regulator - Update and recent activities (cont.)

Our vision is to be a strong, agile, fair and efficient regulator'.

TPR Corporate Plan 2017

Conclusion

As the pensions landscape develops, now with more DC memberships than DB, so do the risks and challenges to be faced over the next few years. As part of the 21st century trustee initiative, TPR have launched a programme of communications on its website covering governance basics. Two have been released at the time of writing: (1) Good Governance – the basics and (2) Clear roles and responsibilities. There is also a guide on producing a good chair's statement to be issued over the coming months.

The PLSA have published a discussion paper 'Good Governance – how to get there'. The paper suggest that 'inputs' (appointing individuals with the expertise, effectiveness, and cognitive diversity) determine the quality of scheme governance rather than the current focus on the 'outputs' (the processes and outcomes). The paper draws on the UK Corporate Governance Code and how the principles could be applied to pension schemes.

As we head closer towards 2018, a year which promises further change and regulation, we await the publication of the DB White Paper to see what new powers TPR will take on and what, if any, additional obligations are imposed on trustees and scheme sponsors.

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General Data Protection Regulations (GDPR) - Implications for outsourced services

As noted in earlier editions of Regulatory Round Up, data protection in the UK is set to receive a rigorous overhaul as the General Data Protection Regulation (GDPR), takes effect from 25 May 2018. The GDPR imposes a responsibility to demonstrate, and evidence, accountability for compliance, including the need to have appropriate processes and procedures in place. Pension schemes, as handlers of personal data, will need to consider their readiness for the revised provisions. There are stiff penalties for non-compliance: a maximum fine of 4% of turnover or 20 million Euros (whichever is the greater).

Trustees are responsible for safeguarding their members personal data. As such, the requirements of the legislation are imposed on them as Data Controllers. However, Trustees will often outsource functions to service providers who, in turn, are treated as Data Processors under the Regulation. Data Controllers will remain responsible for the actions of Data Processors processing data on their behalf – a principle which comes through in other pieces of European legislation, for example the IORP 2 directive. The GDPR stipulates that there should be a contract between the Data Controller and any Data Processors which must contain certain mandatory clauses. These clauses must be in place by May 2018 and subsequently Trustees should implement procedures to confirm ongoing compliance with them.

The contract must be 'binding on the processor with regard to the controller and set out the subject-matter and duration of the processing, the nature and purpose of the processing, the type of personal data and categories of data subjects and the obligations and rights of the controller.'

Furthermore, the contract is required to state that the processor:

(a) Processes the personal data only on written instructions from the controller;

(b) Ensures that processing is undertaken confidentially;

(c) Takes all measures required – i.e. ensuring a level of security appropriate to the risk;

(d) Respects conditions for engaging another processor;

(e) Is adopting appropriate technical and organisational measures, for the fulfilment of the controller's obligation to respond to requests for exercising the data subject's rights;

(f) Assists the controller in ensuring compliance with its own obligations regarding security of processing;

(g) On instructions from the controller, deletes or returns all the personal data to the controller after the end of the provision of services relating to processing, and all copies unless retention is required by law;

(h) Makes available to the controller all information necessary to demonstrate compliance with the obligations of the Regulation and facilitate audits and inspections conducted or mandated by the controller.

Should a Data Processor engage a sub processor to undertake specific activities, the Regulation requires that a contract be in place between the parties which covers the mandatory requirements necessary in the primary processing contract.

The Pensions Research Accountants' Group, 'PRAG', have recently released guidance on compliance with the GDPR. The guidance, which is available to PRAG members, recommends that trustees review their relationships with providers of outsourced activities. In particular, the guidance recommends that trustees review and update existing contracts to ensure that all mandatory clauses are included, that they ensure new contracts are drafted in compliance with the new requirements and that they consider limiting trustee liability. Trustees should also review terms relating to extension of the scope of the work to be performed, retention and destruction of data and protection for personal data on termination of the contract. Cross-border data transfer, liability limitation periods and subject access requests should also be considered.

The guidance further recommends that trustees should engage with sponsoring employers to confirm GDPR compliance as personal data, such as salary information, is highly likely to pass between the scheme and the employer.

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General Data Protection Regulations (GDPR) - Implications for outsourced services (cont.)

Call to action

As Data Controllers, the majority of trustees outsource at least some of their operations to third party providers, with many schemes engaging multiple different service organisations to fulfil the scheme's obligations. Trustees should consider an action plan to both achieve initial compliance with the new rules and, going forward, to plan for appropriate due-diligence over data compliance when planning future outsourcing. With significant penalties possible for non-compliance and limited time before the new regime takes effect, trustees need to seek advice concerning their next steps.

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VAT Update

Pension fund management services provided by regulated insurers – change of HMRC policy from 1 April 2019

HMRC has issued Revenue and Customs Brief 3 (2017), in which they state that, from 1 April 2019, the provision of certain pension fund management services by regulated insurance companies will no longer qualify for VAT exemption. The key consequence of this is that pension fund management services supplied to defined benefit pension schemes by regulated insurers will become subject to standard rate VAT.

To date, regulated insurers have treated all their pension fund management services as exempt from VAT as the provision of insurance in line with UK legislation. In contrast, the provision of pension fund management services supplied by non-insurers is not a contract of insurance. As a result, traditional fund managers have been required to charge VAT on the provision of pension fund management services supplied to defined benefit schemes.

Pension fund trustees should consider all their existing insurance backed pension fund management contracts and assess whether VAT will be incurred post 31 March 2018 and what the financial impact of a 20% VAT charge will be. Trustees will need to determine whether, under their contracts with insurers, they are liable to meet the cost of the VAT and, if they are, how much of this VAT is recoverable.

However, if the scheme uses a collective investment vehicle such as an OEIC, the VAT treatment may not need to change post 31 March 2019. With this in mind, if a VAT cost is likely to arise post 31 March 2019, it would be worth trustees considering whether an alternative, VAT efficient investment structure could be put in place. Clearly, any VAT efficiencies would need to be balanced against other legal, regulatory and commercial considerations.

There are a number of issues to consider as part of HMRC's policy changes to assess what the overall impact could be. Trustees should consider their next steps, including:

- Review of pension fund management contracts in place to determine which of these are potentially at risk;
- Determining which of the 'potentially at risk' contracts will be subject to a change in VAT treatment from 1 April 2019;
- Determining who is responsible for meeting the VAT cost under each affected contract;
- Deciding whether any changes can be made to affected contracts / investment structures to maintain VAT exemption;
- Exploring opportunities to reduce the impact of increased irrecoverable VAT for defined benefit pension schemes;
- Understanding issues to be addressed as part of any contract re-negotiations.

Other VAT news

As noted in previous editions of Round-Up, following the European Court case 'PPG', the traditional 30/70 recoverable/non-recoverable split was under review. Several alternative solutions were proposed and some significant challenges faced. In early November, HMRC issued internal guidance concerning the recovery of VAT going forward. Several options including VAT grouping, tripartite agreements and passing costs onto the scheme are available. A further permissible option is the continued use of the 30/70 split policy. We will follow this up in future editions when more information becomes available.

Contact for queries

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News in brief

FCA Pensions Transfer Consultation Paper

In June 2017 the FCA published CP17/16 Advising on Pension Transfers, consulting on how advice should be provided to consumers on pension transfers where consumers have safeguarded benefits, primarily defined benefit to defined contribution pension scheme transfers. Since the introduction of pension freedoms in 2015 there has been a surge in defined benefit transfers and the requirement to obtain financial advice where the benefits are over £30,000 has caused an additional increase in demand for financial advisers. The new rules aim to reflect the current environment and focus on improving consumer outcomes through raising the quality of advice on pension transfers, allowing more informed decisions to be made. All advice in this area is to be provided as a personal recommendation. In the Paper, the FCA re-state the starting assumption when advising on a transfer of safeguarded benefits, and clarifies that the onus is on the adviser to prove that a transfer is in the best interests of their client.

The FCA requested responses by 21 September, with a policy statement due in early 2018. Final rules are likely to come into force in Autumn 2018.

Changes to anti money laundering requirements

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 came into force on 26 June 2017 implementing the Fourth Money Laundering Directive into UK law.

Key points to note include:

- An individual or company offering professional trustee services to occupational pension schemes falls within the definition of a 'trust and company service provider' (TCSP) and must comply with the anti-money laundering requirements although need not register where their services relate to certain low-risk trusts. Low-risk trusts include occupational pension schemes;
- Trustees will need to comply with new requirements on the retention and disclosure of beneficial ownership information (where beneficial owners can be the principal employer, the trustees and members / prospective members and any other persons exercising effective control over the scheme).

The Fourth Money Laundering Directive requires member states to establish registers of central ownership information and must provide certain information to HMRC by 31 January 2018 if certain taxes are to be paid by the trustees in the tax year 2016/2017. These taxes are income tax, capital gains tax, inheritance tax, stamp duty land tax, land and buildings transaction tax and stamp duty reserve tax.

Action points for trustees include:

- Ensure member data is accurate and up to date;
- Corporate trustees should be ready to respond to any Customer Due Diligence enquiries with beneficial ownership information; and
- Enter the required information on the HMRC website before 31 January 2018.
- Note that trustees found in breach of the regulations could face criminal and civil penalties and employers could then risk reputational issues.

Persons with Significant Control (PSC) – updated requirements

The Persons with Significant Control (PSC) requirements have also been updated. Corporate trustees must now update their PSC register within 14 days of receiving the revised information and a further 14 days to file the information with Companies House. As an additional point for trustees, the **Scottish Partnerships (Register of People with Significant Control) Regulations 2017 (SI 2017 No.694)** came into effect on 24 July 2017 and had similar requirements regarding beneficial ownership. Trustees that have asset-backed funding arrangements involving Scottish Limited Partnerships may want to confirm that statutory filings are being made in accordance with the new obligations. If unsure, we suggest seeking legal advice if this is relevant to your scheme

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News in brief (cont.)

Practice Note 15 Revision 2017

In April 2017, the FRC proposed the revision of PN15: The Audit of Occupational Pension Scheme in the United Kingdom (PN15). A revision was felt necessary to reflect the changes to the UK audited standards (ISAs (UK)), FRS 102 and the Pensions SORP, developments and new guidance from The Pensions Regulator, changes in legislation and the increase in the number of master trusts.

The consultation closed on 30 June 2017 with the FRC receiving 13 responses from audit firms, professional bodies and the Pensions Research Accountants Group (PRAG). Responses received were mixed, although overall the update was well received. Some requested more guidance on master trusts and the impact of auto-enrolment, clarification of the definition of earmarked schemes, on materiality in relation to the auditor's statement about contributions, going concern and the appointment of non-statutory auditors.

As we reported in our Spring edition, ISA 700 requires pension scheme auditors to report in accordance with ISA 570 'Going Concern' on whether the 'going concern' basis of accounting is appropriate in the preparation of the financial statements and to report, by exception, if this is not the case. The going concern assessment is for a period of 12 months from the date of approving the financial statements. Some respondents had concerns that this may lead to an increased number of qualifications if the trustees had not paid particular attention to assessing going concern for a period of at least one year from the date of approval of the financial statements.

The updated Practice Note was published on 8 November 2017.

FCA Policy Statement "Transaction cost disclosure in workplace pensions"

Following its Consultation Paper (16/30), the FCA issued Policy Statement PS17/20 which requires firms managing money on behalf of DC pension schemes to disclose administration charges and transaction costs to governance bodies of those schemes. Firms must now provide:

- information about transaction costs calculated using the "slippage cost" methodology;
- information about administration charges; and
- appropriate contextual information.

The rules do not contain any specific requirements on presentation, but the FCA does see the value of more consistent and standardised disclosure.

The rules take effect from 3 January 2018.

DWP consultation – Disclosure of costs, charges and investments in DC schemes

Following on from the FCA Policy Statement issued in September (see above) ,on 26 October 2017, the DWP launched a consultation on proposed regulations for how costs and charges information for defined contributions schemes should be published and made available to members. The proposals include extending the contents of the annual chair's statement and a requirement to publish costs and charges information on the internet. The consultation also sets out new requirements to disclose certain information relating to scheme pooled funds.

The consultation runs to 5 December 2017, with the revised Occupational Pension Schemes (Administration and Disclosure) Regulations 2018 to take effect from 5 April 2018.

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