Master trusts

Readiness review: lessons learned

September 2018

The Pensions Regulator

Contents

Background

In May 2018 we told you about the 'readiness review' process. This was an opportunity for master trust schemes to submit a draft authorisation application to us. In return we would provide feedback on the quality of evidence submitted and whether it would be sufficient for us to make an assessment of whether they met the criteria. Readiness review feedback does not comment on whether a scheme will be authorised. This decision can only be taken by our Determinations Panel when they receive a formal application.

Submitting a draft application was entirely voluntary. We received 33 draft authorisation applications as part of the readiness review process. We have now reviewed these and have provided feedback to all schemes that applied. This document provides you with the key lessons learned from reviewing the draft applications and highlights where schemes may need to make improvements for authorisation.

General feedback

Don't rush your application. The authorisation window opens on 1 October and stays open until 1 April 2019. So apply when you're satisfied that you can demonstrate you meet the authorisation criteria – rather than as soon as the window opens.

It is important to make sure that all the evidence we need to make an assessment is provided. Certain documents are mandatory; they are required by law. If these documents are not provided we will not consider that a full and complete application has been received and therefore will not start our assessment. You should ensure that all documents that are legally required are provided and clearly signposted. Within individual documents it is useful to explain how sections meet the requirements of the law, particularly within your business plan.

The master trust code of practice explains the ways you may satisfy us that the authorisation criteria have been met. This is further explained in our guidance. Make sure that applications fully consider the expectations set out in the code and guidance. By following our code and guidance more closely, you will be able to provide us with a more complete and robust application. If you choose alternative ways to meet the authorisation criteria, make sure you set out the necessary explanations and evidence in your application.

Applications should clearly explain how the master trust operates. You understand how your scheme and business works so explain that to us in detail, without assuming prior knowledge and avoid using internal acronyms. Your narrative should also include signposting to the evidence which demonstrates this working in practice. You should clearly describe what evidence has been provided and which section (page and paragraph number) supports your narrative.

Trustees should make the application for authorisation. We expect to see evidence of input from the trustees with an emphasis on the interests of members. Some draft applications were more focused on the commercial perspective of the scheme and the interests of the scheme funder.

All our updated forms and guidance are now online so you can start preparing your application. See: **www.tpr.gov.uk/trustees/master-trust-forms.aspx**. We've also created a template that allows you to index the documents you have submitted in the online portal. The index should clearly signpost us to relevant evidence, which supports your narrative.

Key tips

Don't submit additional information without explaining why it's relevant. Providing unnecessary information may dilute our view of the application, ie whether the applicants know how the evidence supports their application. We will only judge a scheme on the information we receive in the final application (not what we received during the readiness review). Make sure you provide us with all the information you want us to take into account when we assess the scheme for authorisation. Consider whether we need to see a full document or if an extract is enough.

1. Meet the procedural requirements of the legislation and code

Make sure:

- your application is complete with all necessary documents included – you may need to include some documents twice to comply with the requirements
- your costs, assets and liquidity plan is included
- the continuity strategy contains enough detail explaining how members benefits will be protected in the event of a triggering event and that you have included the statement of charges
- the trustee's perspective is considered, including reviewing and signing off the application
- you provide a business plan as a comprehensive standalone narrative document

2. Follow our guidance

Make sure you:

- follow our guidance
- provide evidence to support the statements you make
- provide evidence about the collective competence of the trustee board and scheme strategist, and how this meets the fit and proper criteria
- correctly identify all key roles and if there are no parties fulfilling certain roles, eg scheme promoters or marketers, explain why you consider this to be the case
- provide clearly signposted evidence of how your systems and processes meet the required standards
- include the required information in your continuity strategy

3. Explain why information or documents haven't been included

If you haven't included information or documents that we expect to see, as set out in our code and guidance, you should explain why they are not relevant to your scheme as part of your final application.

4. Provide clear signposting

Make sure you:

- clearly reference relevant documents in your answers
- don't include documents without explaining what they're for

Detailed feedback on each criterion

Fit and proper

Identifying your key roles

Make sure you identify the right role holders and the information you provide in other parts of the application supports this, eg business plan.

Where you have not identified key role holders, explain why not (particularly relevant for promoters/marketers) and why you have considered that the definition does not apply to any parties involved in the scheme. If the scheme establisher is no longer involved in the scheme it is useful to explain why this is the case.

Where the scheme strategist is a corporate entity, you should identify all individual directors.

Collective competence

In addition to individual knowledge, it is equally important that the trustee board as a whole is able to demonstrate that they jointly possess the skills, knowledge and experience to run the master trust effectively. While evidence was provided for individual trustee's skills, knowledge and experience, limited evidence was provided of collective competence of the trustee board and why they were appropriate for that specific scheme. Paragraph 85 of the code provides more information on this.

You may want to submit a board skills matrix or other similar document as a way of demonstrating the collective skills, knowledge and experience of the trustee board. For more information on skills and competence, see the systems and process guide.

Update Exchange and other registers (eg Companies House)

We will compare your application with open source data as well as information we hold about you. Where there are conflicts we may ask you to explain. You should make sure your scheme details on our systems and other registers are up to date and ensure that your application mirrors this information.

Systems and processes

We need to be able to understand three key things when assessing against requirements related to this test:

1. Whether the IT system functionality, process or governance function exists
2. How it works
3. How it has been tested to ensure it continues to be effective over time

If your scheme has had material failures of its systems or processes, particularly those that resulted in regulatory action, we need to see external assurance to demonstrate that the issues have been resolved. This is how we suggest you work through the three-step process (using contributions as an example):

1. Consider if your IT system enables you to receive contributions from multiple employers.
2. Show us how this system functionality works in practice.
3. In your narrative, describe the process used to assess whether contributions are continuing to be collected from employers. You should also provide the internal process document which would be used to ensure the process runs effectively and consistently over time.

Providing a complete independent external assessment (such as the AAF assurance framework) is not enough in isolation.

You will need to explain how any control objectives cited in your narrative relate to the specific requirements. If your reporting accountant refers to a process document in their summary review, we need to see that document. You should also make sure that the language used by the reporting accountant to summarise the outcome of tests against control objectives is clear.

Remember to check the scope and coverage of any AAF reports that you submit – some may specifically exclude applicability to master trusts. If it doesn't align with the requirements under the legislation it will not be sufficient.

We have added further information into our final code of practice and the systems and processes guide on how best to evidence our requirements for this test.

There are a large number of very different structures of master trusts which are set to apply for authorisation. We need to understand the structure of each master trust in relation to administration, governance and investment management and how each key function interacts. In the new version of our systems and processes guidance we have asked that you provide us with a structure chart for your master trust. This will allow us to identify all of the key organisations and entities (including service providers and governance functions) involved, allowing us to better assess the quality and effectiveness of systems and processes.

Financial sustainability

The costs, assets and liquidity plan (CALP) forms part of the master trust's business plan. You may present this as a separate document or with the business plan, but it must be present in your final application.

Schemes must calculate their reserving requirements, applying the appropriate haircuts as set out in the code. This is separate from any other reserving requirements (eg the Prudential Regulation Authority) applying to the scheme funder. You must specifically state the costs relating to the master trust. We will take into account reserving requirements for other regulators, but only to the extent that they cover the master trust. In order to show that a funder is reserving against a particular risk, we will require evidence that the risk is fully covered.

Reserves should be separately held and identifiable, and guarantees must be legally enforceable.

You should remember that there is a minimum cash holding in the detailed method. This is unlikely to be less than 15% cash or near cash assets.

If you are using the basic method for calculating the financial reserves, the trustees and strategist need to state that they know no reason why the actual value held in the financial reserves should be higher than calculated on this basis.

Forecasts must be consistent with the evidence of past financial performance submitted.

In relation to the scheme financial template:

- you should only include positive whole numbers – insertion of bracketed or otherwise negative numbers in relation to costs is not required
- you don't need to insert £ symbols
- you should use the Excel template as it stands with all the protections and calculation fields within it – making format changes means that we cannot apply the information directly applied to our model
- make sure you complete all fields – missing information suggests you are not in possession of current accurate data
- make sure there are dates on the columns so that the data is of value
- make sure the data reconciles with information provided within the business plan or CALP submitted
- make sure information reconciles within the template, most notably within communication costs (questions 11 and 13)

Offsetting scheme revenue and scheme income against financial reserving requirements

Authorised master trusts must have sufficient financial resources to cover the costs of dealing with a triggering event, which are made up of two elements:

- the costs of running the scheme for a period of six to 24 months ('run on costs')
- the costs of complying with the statutory requirements that apply during the triggering event period ('costs of compliance')

Together these are referred to as a scheme's financial reserves. The ways that a scheme can demonstrate it has the necessary reserves are broad, and are detailed in the haircuts table of the code[1]. There are no circumstances under which the reserving requirement falls away.

As well as holding assets to meet the scheme's financial reserves, trustees may, with our consent, take into account the income or revenues[2] received by the scheme. We refer to this as offsetting. The readiness review process has identified that some schemes have misused the offsetting option. In these instances, schemes have generally sought to apply the whole or part of their future forecast revenues, without applying the appropriate haircut, to meet part of their reserving requirement. In certain cases schemes have sought to offset their whole financial reserving requirement.

Schemes are required by legislation[3] to have minimum levels of financial resources, and by the code[4] to hold minimum levels of cash within this. An offset should not usually represent a significant proportion of the reserves held by the scheme[5]. Various characteristics of a scheme may influence what could be considered to be significant. We will consider whether an offset is satisfactory on the merits of each case. When seeking an offset, schemes should consider their circumstances, and in particular the effect on the scheme if revenue is lower than expected, and how likely current revenues are to continue after a triggering event. It is never satisfactory for a scheme to seek to offset with its revenue most or all of its financial reserves.

Using an offset does not mean that a scheme can avoid calculating its financial reserves. Schemes that do not present their calculation, using either the detailed method or basic method[6], are unlikely to satisfy us that they are financially sustainable.

We are unlikely to accept any situation where scheme income or revenue is based on a projected amount. We will expect an offset to be based on actual scheme income and/or revenue, evidenced appropriately, including the accounts of the scheme or scheme funder. The exception to this is where a scheme expects these figures to decrease over the period of the business plan.

1 Pages 69-70
2 See page 69 of the code for the definitions of 'scheme income' and 'scheme revenues'
3 Pension Schemes Act 2017 8(2)(b)
4 Paragraph 276
5 Paragraph 246
6 Paragraph 222

Setting the run-on period

As noted above, schemes are required to retain reserves in respect of run-on costs. These are the costs of running the scheme for a period of six to 24 months, as we consider appropriate.

In preparing their submissions for readiness reviews a number of schemes have used a run on period of less than 24 months. These submissions were presented without justifying why a shorter run on period was appropriate.

We set out in the code[7] that we consider that most schemes should base their reserves on a period of 24 months. This expectation is more than just a prudential measure. Our experience is that schemes exiting the market are taking at least 18 months to wind up. In addition, Schedule 5 to the Regulations sets out compulsory activities for schemes that are following continuity option one. These actions would take a scheme at least 12 months to complete.

In a limited number of cases there may be some leeway for schemes with small membership, very few participating employers, or very high common and conditional data scores. Where a scheme feels that reserving for a shorter run on period is appropriate, it should justify this very clearly in its application.

Scheme funder

When you submit the scheme funder accounts you need to provide full audited accounts. You shouldn't present accounts on a small company basis, these are not compliant.

The scheme funder's financial statement must not indicate that they undertake multiple activities if an exemption has not been sought. Our starting position is that the scheme funder should only carry out business directly related to the master trust. If you are requesting an exemption from this requirement you need to state the reasons why you consider an exemption should apply and provide evidence to support this..

Statement of administration charges

Make sure you include the statement of charges, which is required as a section under the continuity strategy.

The statement must include all levels of charges (ie not a range) for the current scheme year, for each charge structure for each arrangement (including the default).

You should clearly set out whether or not any discounts or further charges apply and the reason for imposing the discount or charge.

7 Paragraph 230

Summary

Make sure you are satisfied your application meets the authorisation criteria. It should be clear how the master trust meets legal requirements and the expectations of the code and guidance. This includes providing clear links to the relevant parts of any documents you provide as evidence.

Although the application is broken down into criteria, it's also important you make sure the application is consistent and makes sense as a whole.

Finally, you may find it helpful to get a third-party review to check the quality of your application.

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