ACCOUNTANCY EUROPE.

PENSIONS PROPOSAL: EU OVERVIEW AND US PROFESSION'S SERVICES

Factsheet

FACTS.

FINANCE AND INVESTMENT

MARCH 2018

INTRODUCTION

This paper provides information on the latest EU pension products initiative of the European Commission (EC). It also expands on the profession's role in providing assurance to private pension plans in the United States (US), a country with a long tradition in private retirement plans.

The EC does not include independent assurance in its proposal; we considered appropriate to raise awareness on the latest EU developments in the pensions sector and link them with the relevant profession's assurance services in the US.

WHAT IS HAPPENING IN THE EU?

DISCLAIMER: Information provided below is based on the EC proposal as it stands by this factsheet's publishing date. Negotiations at the European Parliament and European Council are on-going and may end up with different provisions than the ones raised below.

BACKGROUND

On 29 June 2017, the EC launched a proposal for a Regulation on Pan-European Personal Pension (PEPP) Product[1].

The PEPP is a voluntary personal pension scheme that will offer consumers a new pan-European option to save for retirement. This new type of product is designed to give savers more choice when they put money aside and provide them with more competitive products. This initiative complements existing pension plans, whether state-based, occupational or personal pensions and it will not replace or substitute them.

PEPP PRODUCTS PROVIDERS AND THE AUTHORIZATION PROCESS

A broad range of financial companies could offer a PEPP such as insurance companies, banks, occupational pension funds, certain investment firms and asset managers.

As the EC proposal stands now, the European Insurance and Occupational Pensions Authority (EIOPA) will be responsible for controlling and authorising applications submitted by potential PEPP providers.

To provide a PEPP, a provider has to be authorised in accordance with existing EU rules, such as Solvency II for insurance companies or the Directive for Undertakings for the Collective Investment in Transferable Securities (UCITS) for investment firms.

For authorisation, EIOPA will assess: i) whether PEPP products are compliant with the Regulation and ii) how the investment strategy will achieve the retirement outcome contained in the PEPP's contractual rules. It will also publish the list of authorised PEPPs. To ensure high-quality standards for the PEPP label, EIOPA is empowered to withdraw the product authorisation if a provider no longer matches the relevant requirements.

ADVICE FOR SAVERS

The PEPP provider will sell the pension plans upon advice, taking into account PEPP saver's financial situation, investment objectives and also his or her knowledge and experience with investing. PEPP savers will be able to waive their right to advice when purchasing a pension product in the safe default investment option.

[1] Proposal for a Regulation of the European Parliament and of The Council on a Pan-European Personal Pension Product (PEPP) http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017PC0343

DISCLOSURE

Potential PEPP savers will receive information on the pension plans in a PEPP Key Information Document (KID). During the lifetime of the product, PEPP savers will receive periodic information on the state of their savings and fees. The EC claims that this transparency measure and the possibility to switch providers creates incentives for providers to keep their fees low. KID information will include:

- the cost structure of the product
- the risks and rewards of the product
- the different investment options available
- the existing switching options
- how to receive benefits in pay-out

PROPOSED RISK MITIGATION TECHNIQUES

The EC asks for every PEPP to include a lower-risk default investment option with mandatory risk mitigating techniques. Risk mitigation techniques aim to reduce the savers' exposure to risk.

The providers will choose the technique which can take the form of a guarantee such as life cycling (i.e. the portfolio is rebalanced towards safer investments when the saver nears pay-out age), or any other form that provides adequate safeguards for consumers. Providers will take national requirements or specific wishes of consumers into account in implementing the respective technique.

According to the EC, the default investment option should entail capital protection to ensure that the saver recoups at least the nominal capital invested. PEPP providers will be free to offer different investment options with more aggressive or alternative investment strategies; savers will choose on their own initiative and following proper professional advice by the provider and/or distributor on the risks involved. The PEPP saver will be provided with five investment options.

PORTABILITY

PEPP savers will be able to switch to another investment option once every five years. They will also have the right to transfer the product to different Member States by keeping the same provider and the same product.

TAX RECOMMENDATIONS

In its tax recommendation[2], the EC encourages Member States to grant the same tax treatment to PEPPs as to similar existing national personal pension products. This applies even if a PEPP does not match all national criteria for tax relief. It also invites Member States which have more than one type of Personal Pension Product (PPP) to give PEPPs the most favourable tax treatment among their national ones. Finally, the EC will monitor to what extend Member States implement the tax recommendations.

[2] European Commission's recommendation on the tax treatment of personal pension products, including the pan-European Personal Pension Product https://ec.europa.eu/info/sites/info/files/170629-personal-pensions-recommendation_en.pdf

HOW IS THE PROFESSION CONTRIBUTING IN THE US?

In the US, private pensions are often part of the employees' benefits in addition to their normal wages. Frequently, retirement plans require both the employer and employee to contribute money to a fund during employment to ensure (defined) benefits upon retirement. This pool of funds is invested on the employee's behalf and, together with the earnings on the investments, will provide for the benefits of the employee upon retirement.

Employee benefit plans are primarily based on outsourcing and third-party providers. Providers may include custodians, trustees, investment advisors, record keepers, payroll providers, actuaries, valuation experts, etc.

As part of their service, outsourcing companies need to obtain third party assurance to ensure the correct amount of benefits will be paid to the correct employee upon retirement. This provides their clients, the employers and their employees, with comfort about their internal control environment. Specifically, they need to obtain a report on their internal controls from an independent auditor based on the Statement on Standards for Attestation Engagements (SSAE).

SSAE: BACKGROUND

The American Institute of Certified Public Accountants (AICPA), one of the two US audit standards setters, issued SSAE 16 in 2011 to respond to the changing landscape of outsourcing companies (service organizations[3]), as a result of:

- the rise of cloud-based computing
- migration towards international auditing and assurance standards (such as ISAE 3402)
- the overall need to revamp an antiquated auditing standard (SAS 70, the predecessor of SSAE 16 used until 2011)

A SSAE 16 engagement provided transparency around the service organisation's internal controls. SSAE 16 applied when an entity outsourced a business task or function to a specialized entity and the data resulting from that task or function were incorporated in the outsourcer's financial statements. Many US companies would not consider outsourcing to a service organisation which does not have a SSAE 16 report.

SSAE: LATEST CHANGES

In April 2016, the AICPA made an important update to the attestation standards. It introduced SSAE 18 which builds on and supersedes SSAE 16. SSAE 18 guidance is applicable for reports from May 2017 onwards and it primarily clarifies existing standards.

In accordance with SSAE 18, the service auditor (a Certified Public Accountant (CPA)) prepares the Service Organization Controls report (SOC 1 report) that service organizations use in reporting on controls relevant to internal control over financial reporting.

The SSAE 18 also requires the inclusion of defined complementary subservice organization controls when applicable. This aims to provide clarity on how service organizations address their own third-party vendor management obligations (considered fourth-party relationships to user organizations[4]). Therefore, the responsibilities of third-parties need to be defined in the report as they relate to outsourced control activities. These fourth-party relationships and control responsibilities were not always clearly defined in prior SOC reports (under SSAE 16), leaving a potential gap in understanding the complete risk profile of an organization.

[3] Service organisation: the entity that performs a specialised task or function for other entities
[4] User organisation: the entity that outsources the service or function to a service organisation

In addition to the SOC 1 report, there are two more reporting options under the new SOC framework[5]: the SOC 2 and the SOC 3.

- SOC 2 reports focus on controls at a service organization relevant to one or more of the five following Trust Services principles: Security, Availability, Processing Integrity, Confidentiality and Privacy. It also includes a risk assessment requirement to regularly review an organization's controls, adequately address its risks and adjust them as needed. SOC 2 reports are used for reporting on controls for the growing list of I.T. related organizations, namely: cloud computing, Software as a Service (SaaS), managed services, along with data centres.
- SOC 3, with a similar framework as SOC2, is also used for I.T. related service organizations. A SOC 3 report contains management's assertion that the organization has maintained effective internal controls relevant to one or more of the five Trust Services Principles. The report is available to the public.

The SOC framework shows AICPA's keen understanding of the complexities service organisations encountered over the last two decades. and It also indicates the need to provide auditors with tools to meet the growing compliance demands of these organizations.

[5] SOC 2 and 3 reports were already applicable under SSAE 16. SSAE 18 introduced changes to the SOC framework as explained in the text

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