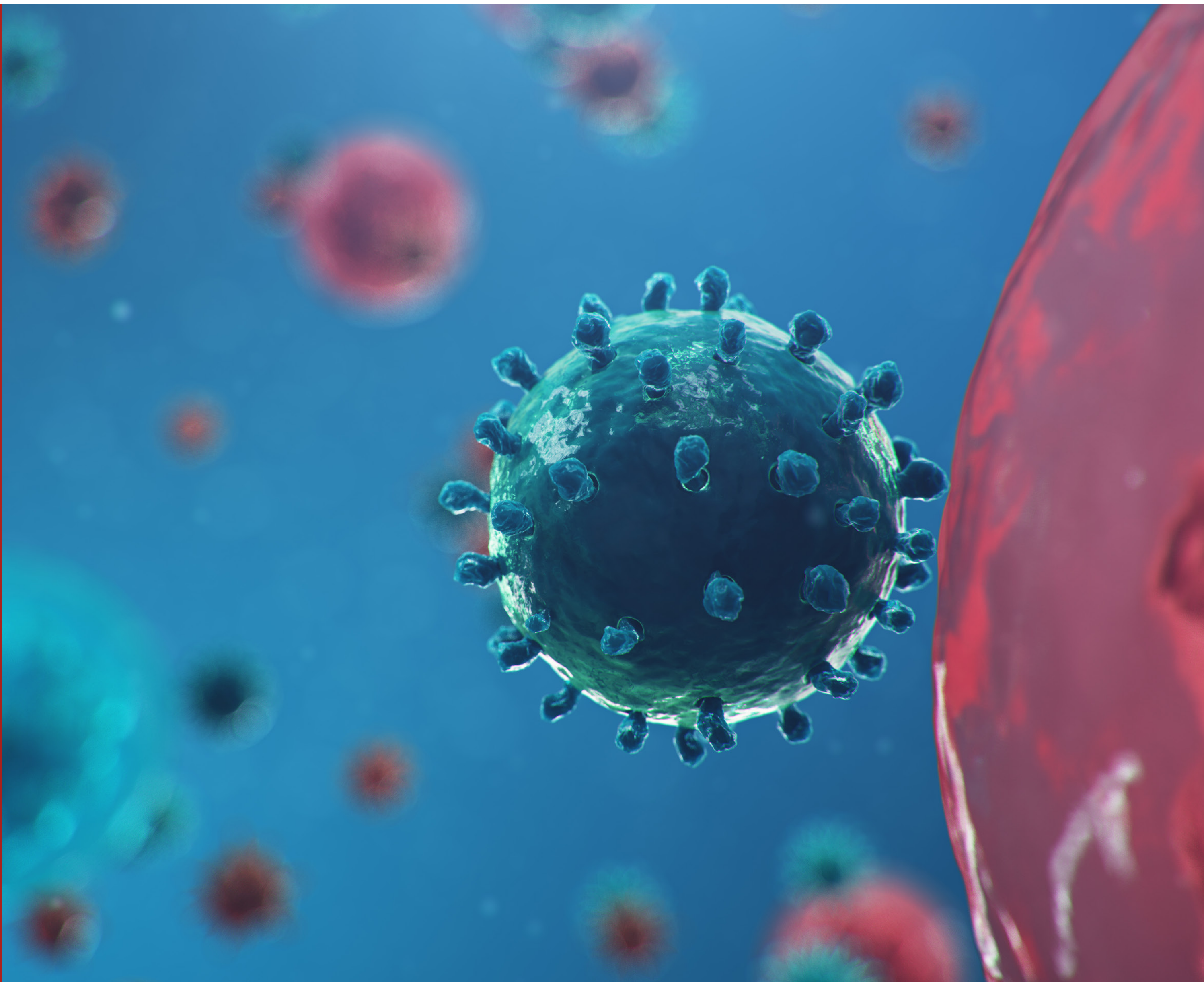
NORTON ROSE FULBRIGHT

COVID-19: Scheme governance issues for pension schemes and online guidance



In this briefing, we provide an updated overview of some COVID-19-related issues for pension scheme trustees and employers.

Given the unprecedented challenges faced by businesses in the current climate, a multitude of guidance has been issued by various regulatory bodies and we have summarised the key materials with relevant web links of which trustees and employers should be aware in relation to pension issues at the end of this briefing. The situation is continually evolving, and advice from both the Government and the Regulator is being updated on a regular basis.

Practical points for trustees and employers

In our March 2020 briefing we set out some general considerations for trustees, including those relating to conducting virtual trustee meetings and signing documents electronically. In this month's briefing we look at some key points and actions which could be raised with advisers and which have emerged or developed in the past month as the regulatory and industry response to the pandemic evolves.

Scheme administration

The uninterrupted continuation of the scheme's administration continues to be key for trustees. The Regulator has acknowledged that many *"non-critical"* trustee and member administrator services may be delayed and that it will *"maintain a proportionate and fair approach"* to any action following administrative breaches.

As noted in our previous briefing, trustees will need to understand their service providers' business continuity plans and how scheme administrators are managing the remote running of scheme business such as payroll IT security and data protection. Trustees should be provided with regular updates from their administrator on whether the agreed timescales for particular services, as detailed in the service level agreement, are being met.

As the pandemic develops, benefit priorities should be discussed with administrators, for example:

- Mature scheme – in a scheme with a high number of pensioners, these benefits should be prioritised, together with retirement processing and bereavement payments.
- Ongoing scheme – here, the collection and investment of contributions will be a priority. The Regulator has confirmed that scheme providers should report late contribution payments at 150 days late, rather than the 90 days set out in its codes of practice.

The regulatory guidance changes as the pandemic develops. For instance, on March 27, 2020, the Regulator confirmed it would take no action up to the end of June 2020 for breaches of the statutory disclosure requirements if trustees decide to suspend cash equivalent transfer values (CETVs), and administrator resources could be reallocated as a result of this, if needed.

Death-in-service benefits

As far as scheme death benefits are concerned, trustees and employers also need to be clear on whether furlough leave affects an employee's death-in-service benefit. Under the Coronavirus Act 2020, changes have been made to the formalities on the registration of deaths, and the formalities of completion of a death certificate. Clarity is needed on the process to be followed in death benefit cases, and whether key requirements in the information procedure in normal times can continue to be met, or may be delayed, during the pandemic.

As noted in our March briefing, the terms of any insurance policy should also be checked to understand if the pandemic will have an impact on payment of benefits and scheme members should also be reminded to ensure their death benefit nominations are up to date.

Member communications

It is likely that some aspects of scheme administration could suffer delays and trustees may wish to alert members to this. For instance, there could be delays in processing member requests to switch investments and in processing requests for transfer values, (where the latter have not been suspended by the trustees).

There is an increased likelihood of scams due to the pandemic and the Regulator has confirmed (in its March 20, 2020 guidance), that members asking about transfers should be urged to exercise extreme caution and should be advised to visit the FCA's ScamSmart guidance. Trustees should also direct members to the Money and Pensions Service (MaPS), particularly those approaching retirement and whose pension savings may have been affected by the current economic conditions.

Members disputes and complaints

Trustees should be aware of the potential increase in member complaints during the pandemic, where scams are rife and administrative delays may be unavoidable. They may wish to contact any members pursuing an existing complaint through the scheme's Internal Dispute Resolution Procedure to warn of possible delays in its resolution due to the pandemic. Pensions legislation provides that trustees process complaints within *"a reasonable period of the receipt of the application".* The legislation does not define *"reasonable period"*, although the Regulator's code of practice provides guidance on timescales. Trustees may also wish to inform members that the Pensions Ombudsman has confirmed that it will not currently be processing new complaints as it can no longer collect and deal with its post, although it states that its website will be regularly updated in light of the changing situation.

It is not clear how this will affect the Ombudsman's *"early resolution service"*, which is aimed at providing quick and informal resolution of complaints or disputes concerning workplace or personal pension arrangements.

Scheme investment issues

Close contact with the trustees' investment advisers is more crucial than ever, as adjustments may need to be made to the scheme's investments to mitigate the impact of the pandemic on scheme funding levels. If trustees wish to amend the scheme's statement of investment principles they must also consult the employer. The effect of the pandemic on certain classes of investment funds may need to be communicated to members. For example, trading in some property funds has been suspended as there are problems in accurately valuing property within the fund.

Where a scheme is in the process of a buy-in or buyout exercise, the trustees should take advice on whether they should proceed. It may be appropriate to revisit decisions, as the crisis is likely to have impacted past pricing.

The employer covenant

Communication between the trustees and the employer is key and trustees should be raising the possible impact of COVID-19 on the sponsor's business, and the likely knock-on impact on the employer covenant. Where there is a risk of deterioration in the employer covenant, the trustees may wish to consider taking advice on altering the scheme's investment and funding strategies. They may also wish to raise the possibility with the employer of making available further security to the scheme in the form of contingent assets. The Regulator is acutely aware of the potential for corporate distress as a result of the pandemic and has issued a series of guidance materials on its expectations for trustees in relation to issues including postponing employer contributions, valuations and dealing with transfer values as discussed further below.

As the COVID-19 pandemic is likely to have a long-term effect on scheme investments, trustees may wish to discuss the ongoing scheme challenges with the scheme's employer and plan an appropriate response.

Pension issues relating to furlough

The Coronavirus Job Retention Scheme (CJRS) has been introduced by the Government to protect businesses and employees during lockdown as a result of the pandemic. It allows employers to agree with their employees a period of paid "furlough" leave, during which the employer will be able to recover a proportion of the employee's pay from HMRC. The CJRS is in place on a temporary basis for four months starting from March 1, 2020, but it may be extended if necessary.

The scheme ensures that employers receive a grant from HMRC to cover the lower of 80 per cent of an employee's regular wage or £2,500 per month, plus the cost of the employer's National Insurance payments and certain pension contributions.

Employees must be designated as furloughed employees by the employer and provided with written notice of their status (including provision by email). Changes to the employment contract must be agreed between the employer and the affected employees.

Pension contributions on furlough leave

Under the CJRS, the employer is able to claim an allowance in respect of the minimum auto-enrolment contribution which would otherwise be due. The amount claimable will be based on 3 per cent of the employee's gross earnings under the CJRS above the lower limit of qualifying earnings used for auto-enrolment. For the tax year 2019/20 this was £512 per month, and from April 6, 2020, it is £520 per month. Employers who pay more than the statutory minimum or who base their auto-enrolment calculations on, e.g. basic salary rather than "qualifying earnings", may therefore not recover the full cost of pension contributions if it exceeds this amount.

The process of reclaiming a portion of contributions for active DB members (and in what amount) is currently unclear and further guidance may be issued by HMRC at some stage.

Where employers make contributions above the statutory minimum and wish to reduce them under the current circumstances, such a reduction could be subject to a statutory consultation, under which the relevant legislation required a 60-day consultation. The Regulator confirms that it will not take action if there is a failure to consult *"for the full 60 days"* and the reduction relates only to the furloughed period. This regulatory easement applies until June 30, 2020.

The CJRS does not cover employee contributions, which will still need to be paid, albeit on reduced wages. In DC schemes, employers may wish to offer employees the opportunity to reduce contributions to the auto-enrolment minimum level. For DB schemes, again, the position is less clear as reductions in employee contributions will affect scheme funding.

Salary sacrifice arrangements

Many employers operate a form of salary sacrifice whereby employees agree a reduced salary in return for an increased employer pension contribution.

The updated HMRC guidance confirms that benefits provided through salary sacrifice schemes (including pension contributions) that reduce an employee's taxable pay cannot be included in the reference salary in respect of which the employer claims for a furloughed employee. The guidance also states that an employee cannot normally switch freely out of a salary sacrifice arrangement but may only do so on the occurrence of a "life event". HMRC has agreed that COVID-19 constitutes such an event.

A key point is that a furloughed employee's reference salary for the calculation of the employer grant is fixed as at March 19, 2020. Therefore, opting out of a salary sacrifice arrangement (or suspending the arrangement entirely, if that is possible) after this date appears unlikely to affect the amount of furlough grant paid to the employer. These options are more likely to be relevant where employers undertake to top up the salary of furloughed workers to some extent for the duration of the furlough.

Comment

The impact of the COVID-19 pandemic on world markets as well as its healthcare systems is unprecedented and as businesses across the globe seek to navigate the challenges brought about by the virus, it is inevitable that disruption to the usual operation of pension schemes will continue for some time. Significant steps have already been taken by government bodies and regulators and it seems this is likely to continue in the short to medium term. We have set out the most important of these which are relevant to UK pension schemes below.

We are also already seeing long-awaited plans for the pensions industry being delayed whilst dealing with the pandemic takes precedence with consultations on DB scheme funding and RPI reform extended and will not now be concluded until the end of Summer 2020 at the earliest. It will be interesting to see how the current situation will be dealt with in the Regulator's annual funding statement, which we understand is due to be published soon. Although there is likely to be significant delay to the implementation of the new DB funding regime, we understand from comments made by the Regulator that it is still expecting to progress the new regime (although the progress of the Pension Schemes Bill through Parliament has also been delayed due to the crisis).

In the current uncertainty and ever-changing landscape affecting UK pension schemes, we are here to help. Your Norton Rose Fulbright adviser is working remotely and can be contacted through the usual channels for advice and support, and updates will appear daily on all aspects of the legal implications of the crisis on our Norton Rose Fulbright website.

Key online guidance

Below we have listed the main sources of guidance for pension scheme trustees and sponsors.

From the Pensions Regulator

The landing page for all the Regulator's guidance is here.

Several detailed guides have been produced and some have been updated since their original publication.

March 20, 2020 – Guidance for DB scheme trustees whose sponsoring employers are in corporate distress.

The guidance lists questions trustees should ask the sponsoring employer concerning the impact of COVID-19 on its business and the employer's ability to meet scheme commitments, in line with the Regulator's Integrated Risk Management guidance. Trustees should determine whether contingent assets may be available to support the scheme and should ensure the scheme is being treated fairly in comparison to the approach taken to other creditors, shareholders and associated companies.

The guidance also sets out the key principles for trustees to keep in mind when considering requests to delay deficit reduction contributions (DRCs). Trustees should consider any requests carefully to ensure that any support given is part of a *"co-ordinated and fair response across key stakeholders".* Any suspension of DRCs should have an end date and triggers to restart if trading returns to normal. In addition, trustees should obtain covenant and legal advice from advisers with experience of corporate distress and restructuring.

March 27, 2020 – DB funding and investment: COVID-19 guidance for trustees.

Recognising the significant challenges for trustees and employers in the current environment, this guidance includes several regulatory easements. In each area, the Regulator indicates that while it cannot waive trustees' statutory obligations, it will not take any regulatory action in relation to failures to adhere to the law. The new easements will initially remain in place until June 30, 2020.

Valuations

The Regulator will allow schemes completing triennial valuations to delay finalisation of the valuation process beyond the 15-month statutory deadline for completing the valuation and associated documents such as the recovery plan. It does not intend to use its powers to fine trustees for late submission of these documents for the next three months.

Suspending deficit reduction contributions

The Regulator will take no action regarding failure to pay deficit-repair contributions (DRCs) for an initial period until June 30, 2020 (extended from May 31, 2020). It expects trustees to consider DRC reduction or suspension requests with the benefit of full information regarding affordability and the employer's covenant prospects. In the absence of clear "covenant visibility" in the short to medium term, the Regulator expects trustees to offer only short-term concessions of up to three months until more reliable covenant visibility is available. Trustees should also have regard to steps taken by other creditors when agreeing any concessions.

Transfer values

The Regulator will take no action in the period up to June 30, 2020, regarding breach of the statutory requirements if trustees decide to suspend CETVs. The Pensions Ombudsman will take this guidance, and the impact of COVID-19 generally, into account when determining whether trustees acted reasonably in their treatment of CETV requests.

The Regulator says it will review these regulatory easements as matters progress. In addition, the Regulator's annual funding statement was promised to be published after Easter and is awaited imminently. This will focus on schemes with valuation dates between September 22, 2019, and September 21, 2020, as well as containing further information for DB schemes generally.

March 27, 2020 – DB scheme funding – COVID-19 guidance for employers.

The Regulator assures employers it will be pragmatic where trustees are being asked to agree to a previously unforeseen arrangement (such as DRC reductions or suspensions, or additional debt being secured over employer assets) provided that the need for such requests can be justified and a plan is made for deferred scheme payments to be caught up, as well as agreeing for mitigating any detriment caused to the scheme. In addition, the scheme must be treated fairly compared with other stakeholders. It expects payments to shareholders (as well as other forms of value leaving the employer) to have ceased.

April 1, 2020 – press release COVID-19: Savers – stay calm and don't rush financial decisions.

The Regulator and the FCA, supported by the MaPS, say fears over the impact of the pandemic on markets and personal finances may make savers more vulnerable to scams or making a decision that could damage their long-term interests. They urge savers to take their time and visit the Pensions Advisory Service website for free plain English pensions guidance before making any decisions about their retirement savings. And to go to the ScamSmart website to learn how to protect themselves from pensions scams.

April 2, 2020 – Scheme administration: COVID-19 guidance for trustees and public service.

The Regulator stresses that for trustees running a public service scheme, it is important to work with the administrators and focus on critical processes, as well as being flexible and pragmatic. Trustees should assess whether the business continuity plan is still adequate and contact their administrator or service provider to find out what contingency is in place to mitigate the impact of increases in work volumes or unavailable staff.

April 9, 2020 – Automatic enrolment and pension contributions: COVID-19 guidance for employers.

This guidance provides several detailed worked examples of contributions to salary sacrifice arrangements and also addresses issues relating to DC scheme certification for auto-enrolment purposes.

April 9, 2020 – Late payment reporting: COVID-19 information for providers.

In this guidance the Regulator announced that it is requiring pension scheme providers to report late payment of contributions to occupational money purchase and personal pension schemes only once they are 150 days late, instead of the current 90 days.

While the Regulator's guidance refers only to "scheme providers", it appears to apply to trustees and managers of occupational money purchase schemes as well as pension scheme providers.

April 17, 2020 – DC scheme management and investment: COVID-19 guidance for trustees.

This guidance notes that trustees face difficult decisions across a range of investment-related areas, and should undertake reviews of several matters, including:

- The degree of their scheme's exposure to certain counterparties and the diversification and extent of any concentrations of risk, whether in specific investments or sectors.
- Any previously agreed investment and risk management decisions due to be implemented in the future.

From other sources

Last updated April 20, 2020, HMRC guidance – Claim for your employee's wages through the CJRS

The Pension Protection Fund: March 18, 2020 – Pension Protection Fund (PPF): Our coronavirus (COVID-19) preparation.

PASA: March 30, 2020 – Pensions and Administration Standards Association (PASA): Covid-19 Guidance for Administrators.

Pensions and Lifetime Savings Association (PLSA):

- March 2020 – COVID-19: top tips for DB schemes and LGPS funds
- March 2020 – COVID-19: top tips for DC schemes
- Pensions Ombudsman: Pensions Ombudsman, Coronavirus (COVID-19) update.
- Financial Conduct Authority – ScamSmart guidance

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1 TNB & Partners in association with Norton Rose Fulbright Australia

2 Mohammed Al-Ghamdi Law Firm in association with Norton Rose Fulbright US LLP

3 Alliances

Contacts

Lesley Browning
Partner
Tel +44 20 7444 2448
lesley.browning@nortonrosefulbright.com

Peter Ford
Partner
Tel +44 20 7444 2711
peter.ford@nortonrosefulbright.com

Shane O'Reilly
Partner
Tel +44 20 7444 3895
shane.o'reilly@nortonrosefulbright.com

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