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Essential pensions news

Updater

April 2018

Introduction

Essential pensions news covers the latest pensions developments each month

Auto-enrolment contributions increase from April 6, 2018

From *April 6, 2018*, both employer and employee minimum compulsory contributions to auto-enrolment pension schemes have increased. The employer's minimum contributions have increased from one per cent to two per cent of earnings between the lower and upper earnings limits, while those for employees have increased from one per cent to three per cent, making a minimum total of five per cent. These minimum contributions are due to increase again from *April 6, 2019* to five per cent and eight per cent respectively.

The Pensions Regulator (TPR) has made minor updates to several of its auto-enrolment-related detailed guidance notes for employers. The changes reflect the increases in the higher and lower ends of the qualifying earnings band that have taken effect for the 2018/19 tax year.

However, the existing content in paragraphs 125 to 166 of guidance note 4, dealing with the steps an employer should take to ensure its scheme continues to count as a qualifying scheme for auto-enrolment purposes in light of the two-stage increase in statutory minimum contributions, has not been substantively altered.

View TPR's detailed auto-enrolment guidance.

Comment

There have been concerns that the increases may prove to be a strain on the finances of smaller businesses and also that they may be viewed adversely by employees once they appreciate the effect on their take home pay. However, auto-enrolment has generally been accepted as a good thing by the majority of the working population, many of whom now find themselves contributing to a pension for the first time. Hopefully, opt-out rates will remain low, and savers will then begin to see their auto-enrolment pension pots increasing by a more meaningful monthly amount.

Master trusts: Pensions Regulator consults on draft code of practice

In our March 2018 update, we reported that the Department for Work and Pensions (DWP) had published its response to the consultation on regulations governing the new master trusts regime. That response confirmed that the detail of the new regime would be set out in a related code of practice, and this has now been published in draft form for consultation which runs until 12 noon on *May 8, 2018*. The consultation also seeks views on what should be included in the accompanying guidance, which is due to be published separately.

TPR acknowledges that the code marks a significant departure from previous codes since TPR itself will, for the first time, be directly authorising and supervising particular pension schemes. At 84 pages, the code is lengthy and detailed, and aims to provide clarity for master trusts on how they apply for authorisation and the issues that TPR will take into account when considering applications.

Authorisation criteria

The majority of the draft code is dedicated to providing detailed information on meeting each of the five authorisation criteria which we set out in our March 2018 update and which are outlined below

- The arrangement must be run by “fit and proper” persons.
- Financial sustainability.
- Any scheme funder must meet specific requirements.
- There must be sufficient systems and processes in place to run the arrangement effectively.
- There must be an adequate continuity strategy.

Timescales

Under the Act, no new master trust may operate without authorisation from the date of commencement of the new regime on *October 1, 2018*. Existing master trusts must apply for authorisation by *March 31, 2019*, or wind up. TPR must reach a decision on whether to authorise a scheme within six months of receiving the application.

TPR’s further documentation

Additional publications produced alongside the draft code include a seven page document setting out TPR’s decision-making procedure to be adopted by the Determinations Panel (DP) when considering an authorisation application. The DP operates independently from other parts of TPR’s organisation and has a separately appointed membership and legal support.

There is also a 27-page Consultation document and response form which sets out some specific questions from TPR on the draft code. Part of the separate guidance on the code is due to be provided during the consultation process, and this may also be commented on in the response form. Further guidance will be published following TPR's conclusion of its forthcoming "readiness review".

Responses to the consultation must be received by 12 noon on *May 8, 2018*.

View the draft code of practice.

Comment

After October 1, 2018, all schemes hoping to continue in, or enter, the master trust market will need to meet the same tough regulatory standards. The Government's view is that the scale and growth of master trusts, and their use for auto-enrolment, requires a rigorous authorisation and supervision regime and the proposed framework is similar to that overseen by the Financial Conduct Authority in respect of personal pension arrangements. That said, affected parties likely to have an extremely busy summer making preparations for the required authorisation application in the Autumn, once the code is finalised after May 8, 2018.

TPR publishes its annual DB funding statement

On *April 5, 2018*, TPR published its annual funding statement for 2018. The statement is aimed at trustees and sponsoring employers of defined benefit (DB) schemes with effective valuation dates spanning the period September 2017 to September 2018 (referred to as tranche 13 schemes).

While TPR's analysis suggests marginally improved funding levels for tranche 13 schemes compared to their previous triennial valuations, the statement flags concerns about what TPR describes as the growing disparity between dividend growth and stable deficit reduction contributions (DRCs).

Noting that recent corporate failures highlight the risk of long recovery periods where dividends are excessive relative to DRCs, TPR says it expects trustees to "negotiate robustly with the employer to secure a fair deal for the pension scheme". Besides dividend risk, TPR urges trustees to monitor other forms of "covenant leakage" such as intra-group loans and transfers at below market value, and take steps to ensure fair treatment for members.

The statement highlights several other areas of risk, including

Transfer activity
Reflecting reported high levels of transfers out, TPR says that if trustees wish to include an allowance for future transfers in their technical provisions, they must review their scheme's experience and likely trends very carefully.

Scheme maturity
TPR expects advisers to alert trustees to the risks to funding and investment from increasing scheme maturity, particularly in light of an increase in transfers.

Brexit uncertainty
Where appropriate, TPR expects trustees to have "open and collaborative discussions with their sponsors" about the potential impact of Brexit. If sponsors wish to extend recovery plans because of Brexit-related uncertainty, trustees should ensure shareholders are sharing the burden proportionately and seek other forms of security from sponsors.

View the funding statement.

View TPR's summary of key messages from the funding statement.

Comment

The 2017 statement with its focus on "stressed" schemes represented a clear indication from TPR that it intended to take a much closer look at how schemes were managing risk, covenant and funding governance and that schemes were expected to take steps appropriate to their circumstances. TPR then expressed the view that contingency planning was appropriate for all schemes, not just those at risk. TPR stated that it intended to intervene early where a scheme was not being treated "fairly".

In the 2018 statement, TPR expands on some of last year's themes with its emphasis on encouraging trustees to seek increased support from employers, particularly where dividends paid are considered to be high in comparison to any funds made available for scheme funding deficit reduction. The main difference is the increased focus on schemes with stronger employer covenants which TPR believes should still strengthen technical provisions and shorten recovery plans.

Brexit is mentioned specifically in the 2018 statement. It is clear that, in the current uncertain economic climate, TPR takes seriously its role of balancing two of its competing statutory objectives to protect members' interests while supporting scheme funding arrangements that are compatible with sustainable growth for the sponsoring employer.

TPR publishes guidance on cybersecurity for trustees

TPR has published guidance for trustees setting out good practice for pension schemes in dealing with "cyber risk". TPR defines this broadly as the risk of loss, disruption or damage to a scheme or its members as a result of the failure of its information technology systems and processes. Risks may relate to a scheme's information as well as its assets, and may take the form of internal risks (for example, from staff) or external risks (such as hacking).

The guidance considers the steps needed to build a scheme's "cyber resilience" as well as those required when a cybersecurity incident strikes a scheme. Among other things, the guidance says trustees should

- Ensure they fully understand their scheme's cyber risk, not least through developing an awareness of the scheme's "cyber footprint" (in other words, the extent of the digital presence of all parties involved in the scheme). The likelihood of different types of breaches occurring should be assessed, and the possible impact of cyber incidents on the scheme's operations evaluated.

- Ensure sufficient controls are in place to minimise the risk of cyber incidents. Cyber risk should appear on a scheme's risk register and be regularly reviewed. In addition, trustees should assure themselves that their third-party suppliers have sufficient cybersecurity controls in place.

- Maintain an incident response plan, designed to help the scheme recover swiftly after a cyber incident. This should include details of the necessary formalities for reporting incidents to TPR, Financial Conduct Authority or Information Commissioner's Office, as appropriate.

Noting that cyber risk is evolving, the guidance urges trustees to ensure they keep up to date about the subject and, if necessary, seek guidance on cybersecurity threats from the National Cyber Security Centre.

View TPR's Cybersecurity principles for pension schemes (April 2018).

PPF publishes 2018–2021 strategic plan

The Pension Protection Fund (PPF) has published its strategic plan for 2018–21, setting out how it intends to achieve its objectives over this period. To date, 380,000 members have transferred to the PPF and it has some £37 billion in assets under management. It forecasts that around 60 schemes will enter assessment in 2017/18 (up from 45 in 2016/17).

The PPF's work focuses on three key strategic objectives

- Meeting its funding target through prudent and effective management of its balance sheet. Although the operating environment over this period continues to pose significant uncertainties (particularly surrounding Brexit), the PPF confirms that it remains on track to meet its funding target.
- Delivering excellent customer services to members, levy payers and other stakeholders.
- Maintaining a high calibre framework of risk management. The PPF notes that there are opportunities to challenge corporate behaviour that increases risk to levy payers and to improve outcomes for schemes and employers in genuine distress. It will contribute to the debate on how the DB regulatory regime should evolve in relation to the proposals in the White Paper.

The PPF also plans to develop its approach for the fourth levy triennium, beginning 2021/22, and aims to have consulted and confirmed its proposals by the end of this planning period. This follows the start of the third triennium in the forthcoming levy period and the introduction of a number of improvements to the PPF's approach, including the use of credit ratings to derive insolvency risk scores for some of the largest levy payers.

The PPF also confirms that it will raise a fraud compensation levy again in 2018/19, at the same level as in 2017/18 (25p per member).

View the Pension Protection Fund Strategic Plan 2018-21.

PPF updates section 179 valuation assumptions to reflect bridging pension changes

In our January and February 2018 update, we reported on the DWP's consultation on technical provisions in the draft Pension Protection Fund (Compensation) (Amendment) Regulations 2018 (the Amending Regulations). The Amending Regulations allow the PPF to take account of bridging pensions where scheme rules provide for such benefits, and came into force on *February 24, 2018*.

The PPF has now published a revised version of its section 179 valuation guidance to reflect these regulatory changes. Without the Amending Regulations, the member could have been entitled to a higher level compensation for life within the PPF, whereas had the pension scheme not entered, scheme pension payments would have reduced when the bridging pension ceased.

This new version of the guidance should be used for valuations with an effective date on or after *April 6, 2018*.

View the Guidance.

FCA and Pensions regulator seek feedback on joint strategic approach to pensions regulation

On *March 19, 2018*, the Financial Conduct Authority (FCA) and TPR published feedback on their joint strategic approach to regulating the pensions landscape.

The joint strategy clarifies the current respective remits of the two bodies and how they overlap. The strategy further outlines how these regulatory bodies intend to work together in future to tackle pension industry challenges such as those relating to increased life expectancy, the closure of DB schemes, a rise in pensions savers owing to auto-enrolment and increased use of master trusts.

In the call for input, views are sought on current and future risks to the industry. In particular, TPR and the FCA have identified five key areas where their remits could intersect to address the risks, and raise a number of specific questions. The main areas are

Access to pensions
What more can the FCA and TPR do to support pension savers?

Effective governance and scheme funding
Is there a broader scope for TPR and FCA to work, either singly or jointly, in this area and to what extent could they work with wider bodies to improve advice and services supplied to schemes?

Security of pensions savings
How can pension schemes, providers, employers and other industry members improve the security of the data and money that they hold, and how can the FCA and TPR help to drive up standards?

Value for money in pensions
Are there further opportunities for the FCA and TPR, either separately or together, to support the delivery of value for money pensions?

Supporting good choices and outcomes for members
How can the FCA and TPR work to ensure than the information and advice given helps consumers make appropriate decisions, and when are people most vulnerable to taking poor decisions?

The deadline for responses is *June 19, 2018*. The FCA and TPR will publish the final strategic approach, in light of the recommendations, in *Autumn 2018*.

FCA issues policy statement on DB pension transfers advice and consults on further changes

On *March 26, 2018*, the FCA published a policy statement setting out its new rules on pension transfers (PS18/6), following a consultation conducted in June 2017. Most of the new requirements came into force on *April 1, 2018*, with some coming into force on *October 1, 2018*, and others on *April 6, 2019*.

The policy statement confirms that the FCA has decided to maintain the position that an adviser should start from the assumption that a defined benefit (DB) pension transfer will be unsuitable. It seems that this may reflect the high proportion of unsuitable advice the FCA has seen in supervisory work, and the need for further consideration of how transfer advice should be paid for.

The FCA is also seeking views on additional changes to its rules and guidance in this area. These are outlined in a consultation paper on improving the quality of pension transfer advice (CP18/7), published alongside PS18/6. The proposals include

- Requiring advisers undertaking pension transfer advice (pension transfer specialists) to have the same qualifications as investment advisers, to come into effect by October 2020.
- Guidance clarifying the FCA's expectations that advisers should be exploring individuals' attitudes to the general risks associated with a transfer away from DB, in addition to their attitude to investment risks.
- Guidance illustrating how firms can carry out an appropriate "triage service" (an initial conversation with potential customers), without stepping across the advice boundary.
- Requiring firms to provide a suitability report regardless of the outcome of advice. Currently, if an individual is advised not to proceed with the transfer, there is no requirement to provide that client with a report.

The FCA is also seeking views (but not proposing rule changes) on possible intervention on adviser charging structures, given the difficulty in managing the conflicts of interest that exist when providing transfer advice. This could include a ban on contingent charging, which is when a fee for advice is only paid for when a transfer goes ahead.

Comments are invited on these proposals until *May 25, 2018*. The FCA intends to publish feedback and final rules in a policy statement by early Autumn 2018, at which time it will outline any proposed action on charging structures.

View the policy statement.

View the consultation paper.

DWP confirms advice requirement to be retained for overseas transfers

The DWP has confirmed that it intends to retain the advice requirement for overseas transfers of “safeguarded benefits” and that no easement is required in respect of such transfers. The statutory advice requirement applies when an individual with “safeguarded benefits” (essentially, DB benefits) worth more than £30,000 wishes to transfer these to another pension scheme in order to take advantage of a flexible access option, or convert them to flexible benefits in their own scheme.

HMRC publishes countdown bulletin no. 33

Of interest to schemes that were formerly contracted-out on a DB basis, is the latest edition of HMRC’s Countdown Bulletin for administrators, which was published on *April 16, 2018*.

Countdown Bulletin no. 33 has updates on

- Multiple periods automated solutions.
- Phase 6 automated solutions.
- Scheme cessation reminders.
- Refund for Scheme Reconciliation Service queries.

View the Bulletin.

Finance Bill 2018 receives royal assent

The Finance Bill 2018 (referred to in Parliament as the Finance (No.2) Bill 2017-19) received Royal Assent on *March 15, 2018*, becoming the Finance Act 2018.

Provisions relevant to the pensions industry are

- Amendments to the Finance Act 2004 intended to make it more effective at combatting fraudulent schemes extend the circumstances in which HMRC will be allowed to refuse to register or deregister a pension scheme to include
  - Where the sponsoring employer of an occupational pension scheme has been dormant for a continuous period of one month that falls within the period of a year ending with the day on which the decision is made.
  - Where the scheme is an unauthorised master trust.

The amendments concerning dormant companies are intended to came into effect on *April 6, 2018*. The amendments in relation to unauthorised master trusts will come into force on the same day as the relevant provisions of the Pension Schemes Act 2017 (prohibition on operating a master trust scheme unless authorised), currently due on *October 1, 2018*.

The National Employment Savings Trust (Amendment) Order 2018 – technical changes made to NEST's governing provisions

The National Employment Savings Trust (Amendment) Order 2018 amends the provisions governing NEST and came into force on *April 6, 2018*, with only minor changes made following the consultation which started in November 2017.

The Order will amend the National Employment Savings Trust Order 2010 to

- Allow employers to contractually enrol their workers in NEST from *May 25, 2018*, when NEST's employer rules are updated.
- Allow individuals to join NEST following a bulk transfer with consent. The amendments clarify that any amount received in relation to a member's employment will be applied to a member's account.
- Giving the NEST trustee the ability to terminate the participation of "dormant" employers who have not contributed to NEST for a specified period of time, by giving notice to the employers. The period of time will be confirmed at a later date.
- Allow NEST to close a member's account where the balance is zero, if certain conditions are met.
- Require the NEST Corporation to conduct research about the scheme's administration and management with members, participating employers and their representatives in connection with the operation, development or amendment of the scheme. This new duty is intended to reflect the introduction of the General Data Protection Regulation (GDPR) on *May 25, 2018,* and provide NEST with a clear basis on which to process data lawfully in future.

NEST's proposal to streamline the current death benefit rules, and to allow members to opt into a discretionary regime for the payment of death benefits, where they are concerned about the impact of inheritance tax, will not go ahead for the time being.

A summary of further pensions issues in the pipeline

As a new addition to the update, we are providing a monthly chronology of pension changes expected in the near future in addition to those outlined above:

Steria (Pension Plan) Trustees Ltd v Sopra Steria Ltd and others: High Court claim seeking declaration regarding the requirement to obtain a section 37 certificate. The case was heard on May 22, 2017. The claim has been stayed until *June 18, 2018,* with both parties having been ordered to update the court before *April 5, 2018.*

The deadline for certifying deficit reduction contributions for the 2018/19 PPF levy is *April 30, 2018.*

Ban on member-borne commission – the deadline for service providers to send trustees written confirmation of compliance with the ban on member-borne commission for pre-April 6, 2016, contracts where payment was made on or after October 1, 2017, is *May 1, 2018.* This applies where the scheme is used a "qualifying scheme" for auto-enrolment and some or all of the benefits are money purchase.

The General Data Protection Regulation comes into force on *May 25, 2018*. As data controllers, trustees will need to ensure that compliance is achieved by this date.

Clarification of trustees' fiduciary duties in relation to longer term investment risks – the DWP has confirmed in a response to a written Parliamentary question that it will publish its full response to the 2017 Law Commission report, *Pension funds and social investment*, by *June 2018*.

EMIR – new requirements to the exchange variation margin relating to derivatives applied from March 1, 2017. If an investment manager uses over the counter derivatives, schemes should check that arrangements are in place for trustees to comply with the new regime. A further EMIR exemption extension for pension scheme arrangements now applies to *August 16, 2018*. An additional three year clearing extension is proposed.

The Pension Schemes Bill 2017 received Royal Assent on April 27, 2017. The legislation is concerned principally with provisions relating to the authorisation of master trusts. The new regime for master trust regulation, upon which the Government's response to the consultation is awaited, is likely to be brought fully into force on October 1, 2018.

IORP II – the expected transposition date is *January 12, 2019*.

Brexit should be achieved by *March 29, 2019*. The UK will then leave the EU from the effective date of withdrawal agreement or, failing that, two years after giving Article 50 notice unless European Council and UK unanimously decide to extend period.

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