NORTON ROSE FULBRIGHT

Essential UK Pensions News

September 2020

Introduction

Essential UK Pensions News covers the latest pensions developments each month.

Government publishes response to consultation on Investment Innovation and Future Consolidation

The government has published its response to the February 2019 consultation "Investment Innovation and Future Consolidation". It also includes further consultation on certain statutory changes designed to support and accelerate the process of DC consolidation. The changes would require trustees of smaller schemes to assess whether the scheme provides members with value for money and if it is shown that members would achieve better value in a larger scheme, the trustees would be expected to initiate wind up and consolidate.

In the ministerial foreword, Guy Opperman MP states that *"there remain large numbers of smaller DC schemes many of which are poorly governed, have on average higher charges and do not have the scale to bring the benefits of investing across a broad range of asset classes."* The government is therefore *"bringing forward measures that will ensure that we tackle persistent underperformance and poor governance by accelerating the pace with which the market is consolidating. This will bring the benefits of scale to all scheme members including a greater capacity to take advantage of illiquid and other alternative investment classes."*

In relation specifically to consolidation, the consultation states that *"the government views accelerating the consolidation of the DC market into fewer, larger schemes as a priority. For this reason, the efficacy of any amendments made to regulations such as the current proposals will be kept under review. If any new requirements do not drive consolidation at sufficient pace, the government will develop legislation to mandate consolidation."*

A summary of the main changes is below:

Consolidation

- Requiring all relevant schemes to report on the return on investments of default and member selected funds.
- Requiring schemes with assets below £100 million to report on how their scheme presents value for members taking into account costs and charges, investment returns and various elements of governance and administration.
- Requiring schemes with assets below £100 million that do not present value for members to report this outcome in their scheme return.
- Requiring all relevant schemes to report to the Pensions Regulator (TPR) the total amount of assets held in the scheme in the annual scheme return.

Diversification, performance fees and the default fund charge cap

- Amending the relevant regulations to provide an easement to the requirement to prorate performance fees when assessing compliance with the charge cap.
- Amending the relevant regulations to exclude the costs of holding "physical assets", such as real estate or infrastructure, from the charge cap (this exclusion is already included in the guidance but the proposed amendment would put this on a statutory footing).
- Updating the charge cap guidance to clarify the treatment of underlying costs in investment trusts.

Other changes

- Extending the requirement to produce a default Statement of Investment Principles (SIP) to "with profits" schemes
- Extending the costs disclosure requirements to funds which are no longer available for members to choose
- Excluding wholly insured schemes from some of the SIP requirements.

Most of the proposed changes apply to "relevant schemes" (broadly schemes offering money purchase benefits other than AVCs alone).

It is proposed that the changes would come into force on October 5, 2021. The new consultation closes on October 30, 2020.

Comment

The consultation includes significant proposed changes to the governance of DC schemes, with smaller schemes likely to be most affected. The government's underlying purpose is to get more pension investment in infrastructure and other patient capital investments, which it sees as easiest to deliver from larger schemes. As a result it is committed to pushing forward with consolidation and has made it clear that if the current proposals do not result in increased consolidation, then further more stringent proposals are likely to follow. Many of the changes proposed are likely to increase the costs of small DC schemes to the point where winding up and transferring members to a larger scheme is the only viable solution. This may be the right solution for unloved and poorly governed schemes, but the proposals as currently constructed risk throwing the baby out with the bathwater by pushing the best-governed schemes under first. A work in progress.

Regulations extend some but not all of the temporary measures included in the Corporate Insolvency and Governance Act 2020

The Corporate Insolvency and Governance Act 2020 (Coronavirus) (Extension of the Relevant Period) Regulations 2020 will come into force on September 29, 2020. These extend some but not all of the temporary measures included in the Corporate Insolvency and Governance Act 2020 relating to insolvency, which would otherwise have expired on September 30, 2020.

Among the provisions which have been extended until December 31, 2020 are the prohibition on statutory demands, winding up petitions and winding up orders in relation to companies which have suffered a financial effect by reason of the COVID-19 pandemic.

The relaxation of the criteria for companies to obtain a moratorium are extended until March 31, 2021.

PLSA publishes its response to the consultation on reform to the RPI methodology

Summary

The Pensions and Lifetime Savings Association (PLSA) has published its response to the joint consultation from the Treasury and UK Statistics Authority (UKSA) on proposed reforms to the Retail Prices Index (RPI) methodology.

While supporting the government's plans to develop a "more robust" measure of inflation, the PLSA has cautioned that steps will need to be taken to mitigate the detrimental impacts of aligning RPI with CPIH (the Consumer Prices Index including owner occupiers' housing costs).

Background

In March 2020, the government launched a consultation about its plans to align RPI with CPIH. One of the main issues which the government was seeking responses on was that of timing, namely whether the proposals could be brought into effect before 2030, and if so, when between 2025 and 2030.

Response from the PLSA

The PLSA's response emphasises that it *"understands that RPI is a flawed measure of inflation, and supports plans to develop a more robust measure"*. However, it raises concerns around the timing of introducing these changes, as this will affect the extent of the impact on pension schemes, who are one of the main investors in index-linked gilts, and by consequence on pension scheme members. The PLSA's response sets out the following example to illustrate the importance of timing in introducing these changes:

"Depending on the timing of the changes, pension scheme members will lose between 4-9 per cent of their pension value. The yearly average DB income with RPI uprating of a man aged 65 in 2020 is predicted see a drop of 17per cent if changes are made in 2025 and women aged 65 will see a drop of 19 per cent. If the change is made in 2030, a man would see his yearly average income fall by 12 per cent, while a woman would see her income reduce by 14 per cent."

In order to ensure that the transition is *"fair and equitable"*, the PLSA recommends that certain mitigation is put in place to reduce the detrimental impact, including adjusting index-linked gilts to reflect the expected long term average future income of RPI over the new inflation measure or alternatively compensating index-linked gilt holders upfront for any future lost income. In addition, the PLSA recommends that the changes are implemented as close to 2030 as possible.

ACA responds to TPR's consultation on DB funding code

Summary

The Association of Consulting Actuaries (ACA) has responded to TPR's consultation on the new DB funding code. While the ACA broadly supports TPR's proposals in relation to the twin-track approach, it has called for TPR to provide further detail and clarification on a number of points.

The Chair of ACA's Pension Schemes Committee, Peter Williams, commented as follows: *"The ACA supports TPR's twin track proposals. But we need to see details on how the 'Bespoke' option will work in practice to be confident in the new regime. It is important that the current scheme specific funding flexibility is maintained, as this must be balanced with the needs of supporting the sustainable growth of UK employers."*

"The ACA supports TPR's proposal to introduce a 'Fast Track' option and that TPR uses 'Fast Track' as the yardstick for accessing its powers under s231. But this must not mean that TPR compels schemes using 'Bespoke' to fund to 'Fast Track equivalence' by default. 'Bespoke' must remain as a genuinely scheme specific alternative."

DWP publishes consultation on governance proposals for trustees in relation to managing climate change risks and opportunities

On August 26, 2020, the Department for work and Pensions (DWP) published a consultation on proposals about governance and reporting requirements for trustees in relation to climate risks and opportunities. This follows the proposals made by the Task Force on Climate-related Financial Disclosures (TCFD) in 2017.

Broadly, the proposals apply to schemes with assets worth more than £5 billion, authorised master trusts and authorised schemes providing collective money purchase benefits. These schemes would be required (i) with effect from October 2021 to put in place effective governance, strategy, risk management and accompanying metrics and targets for the assessment and management of climate risks and opportunities and (ii) within 7 months of the end of the scheme year which is underway on October 1, 2021, or by December 31, 2022, if earlier, to publish a TCFD report.

Failure to publish a TCFD report would result in mandatory penalty from TPR, with other penalties subject to TPR's discretion.

The DWP is proposing that these requirements would be extended to schemes with more than £1 billion in assets with effect from October 2022 and that there would be a review in 2024 before a further extension of these requirements to schemes with less than £1 billion in assets.

The consultation closes on October 7, 2020.

PLSA publishes guide on climate indexes

The PLSA has published a guide on climate indexes. The guide, which was sponsored by and produced with the help of MSCI, is aimed at illustrating how equity and fixed income indexes can be a relevant tool for institutional investors in portfolio construction. It also aims to present how climate risk indexes may be used as part of an approach to manage climate-related risks and integrate them into the investment process.

The guide notes that *"measuring and managing climate risk has become an ever-more important tenet of the investment process. So is identifying new and innovative low-carbon investment opportunities, to help build more climate-resilient portfolios.*

Until now, measuring the potential impact of transitional or physical risks or the economic impact of climate change on portfolios was limited due to the lack of tools available to investors.

We believe climate change will become the most important investment risk factor over the long-term and MSCI is committed to creating solutions to support investors' decision-making. Institutional investors should be able to analyse the exposure of their portfolios to climate risk and opportunities while also being able to report on their climate strategy. We hope this guide goes someway to support them with their objectives."

TPR publishes quarterly compliance and enforcement bulletin

TPR has published its quarterly compliance and enforcement bulletin for April to June 2020. The bulletin shows a notable drop in the use of TPR's powers during this period. For example, TPR issued 1,555 fixed penalty notices during this period, in contrast to 9,913 in the period between January and March 2020 and only 625 escalating penalty notices, compared to 3,571 in the previous quarter. However, the number of statutory notices in relation to compliance with the auto-enrolment requirements has stayed relatively constant.

There was also a significant reduction in the number of unpaid contributions notices (352, as opposed to 10,410 in the previous quarter). TPR introduced an easement in April 2020 which changed the requirement to report late contributions after 90 days to 150 days.

In a blog, TPR confirms that this was a result of the change in its enforcement policy in relation to the COVID-19 pandemic so as *"to ease the burden on employers caused by the pandemic in a practical and proportionate way".* However, it states that it has *"remained firmly focused on rooting out and taking action against employers who have been wilfully non-compliant and committed serious breaches."*

Comment

The drop in TPR's powers is consistent with its stated approach to enforcement action during the COVID-19 pandemic. However, auto-enrolment clearly remains an important area of focus for TPR, as its enforcement action in this area has remained very similar.

Government confirms increase to normal minimum pension age in 2028

The government has confirmed that it remains its intention to increase the normal minimum pension age from 55 to 57 in 2028. Stephen Timms MP, who is Chair of the Work and Pensions Committee, submitted a written question to the Chancellor of the Exchequer on this point. John Glenn MP, Economic Secretary to the Treasury and City Minister, responded to the question on September 3, 2020 stating that the government intended to continue with the timetable for this change which was announced in 2014 *"well in advance to enable people to make financial plans"* and that the change will be legislated for *"in due course".*

PLSA publishes its response to TPR's consultation on DB funding code and the twin track approach

In its response to TPR's consultation on the DB funding code, the PLSA has expressed support for the overarching principles but is concerned about the effects of some of the detailed proposals on pension schemes.

The PLSA is concerned that the *"proposed code is too prescriptive with elements too 'one-size fits all' which may lead to outcomes that are not in savers' interests."* The PLSA has called for TPR to revisit its proposals to ensure that the "fast-track" approach has *"greater optionality"* for schemes and that the "bespoke" approach is *"not anchored to its fixed assumptions".*

While the PLSA supports the general principle of encouraging schemes to reduce their reliance on employer covenant and investment risk over time, it is worried that TPR's proposals in the funding code are *"too inflexible and may have negative consequences or result in unnecessary de-risking, which would not be advantageous or desirable for many schemes, and in particular those with a strong employer covenant."*

The PLSA is also concerned that the proposals may unintentionally hasten the closure of open DB schemes, by increasing the burden on funding requirements and potentially making new accruals *"prohibitively expensive".*

New regulations revoke and replace previous regulations in relation to PPF's powers during a corporate restructuring

The Pension Protection Fund (Moratorium and Arrangements and Reconstructions for Companies in Financial Difficulty) (Amendment and Revocation) Regulations 2020 (the New Regulations) came into force on 16 September 2020. These revoke and replace the Pension Protection Fund (Moratorium and Arrangements and Reconstructions for Companies in Financial Difficulty) (Amendment) Regulations 2020 (the Old Regulations).

Under the Corporate Insolvency and Governance Act 2020, companies in financial difficulty can take advantage of new corporate restructuring options, including obtaining a moratorium.

The Pension Protection Fund (Moratorium and Arrangements and Reconstructions for Companies in Financial Difficulty) Regulations 2020 allowed the PPF to step in to the trustees' role as a creditor in certain circumstances. The Old Regulations sought to extend the scope of these regulations to situations where a moratorium or restructuring plan was in place in relation to a co-operative society or a community benefit society which has a pension scheme which is eligible for the PPF.

However, due to a technical error in the Old Regulations, these have been revoked and replaced by the New Regulations.

TPR confirms that schemes must return to reporting late contributions within 90 days from 2021

TPR has updated its COVID-19 guidance which confirms that, with effect from January 1, 2021, schemes and providers must return to reporting late contributions no later than 90 days after the due date. This timeframe was extended at the start of the pandemic in March 2020 to 150 days to allow employers who were financially struggling more time to resolve late payments.

TPR has also confirmed that from October 1, 2020, it will start returning to normal in respect of its other enforcement activity, including enforcing the requirement for schemes to submit audited accounts and investment statement reviews, and it will restart reviewing any chairs' statements which are submitted on and after this date.

High Court issues summary judgment in relation to rectification of early retirement provisions in respect of deferred members

Summary

In an application for summary judgment, the High Court has awarded rectification in relation to two definitive deeds and a deed of amendment governing the SPS Technologies UK Pension Plan (the Plan). The error arose in the 1998 definitive deed and was then replicated in a subsequent definitive deed and a deed of amendment.

Further detail

The error which arose in the 1998 definitive deed and for which rectification was sought related to the early retirement provisions for deferred members. Under the Plan, there is a type of member defined as a "Transferred Member" which means any member who at any time had been granted pensionable service under the Plan in respect of his membership of a "Previous Plan".

As part of the drafting of the 1998 definitive deed, the early retirement provisions were updated. The intention was to provide Transferred Members with a right to retire early from deferment, subject to an actuarial reduction (previously there was only a right for them to retire early from pensionable service with the consent of the employer and subject to an actuarial reduction). However, as a result of a mistake in the drafting, the provisions in the 1998 definitive deed disapplied the actuarial reduction where a Transferred Member retired from deferment after age 60. Rather than aligning the early retirement provisions for Transferred Members, whether they retired early from pensionable service or deferment, the drafting created a *"striking difference"* between these early retirement provisions. The error was carried forward unnoticed into subsequent versions of the Plan's governing documentation.

The court noted that the drafting was *"inherently illogical"* in that it favoured Transferred Members who had left the employer, possibly to work for a competitor, over Transferred Members who had remained working for the employer. However, the claimant needed to provide the court with "convincing proof" that an error occurred in 1998 and became embedded in the Plan's documentation until it was discovered in 2009. The court noted that the claimant had carried out *"a great deal of painstaking work that is reflected in the careful evidence that has been provided to the court in 10 witness statements."*

The power of amendment under the Plan rules is unilateral (only the employer had to approve the amendments), so it was only the intention of the employer which was relevant to the case for rectification, and not the intention of the trustees. Intention should be assessed subjectively. In terms of the rectification of successive deeds, the court, following Warren J's judgment in *IBM UK Pensions Trust Ltd v IBM UK Holdings Ltd and others [2012] EWHC 2766 (Ch)*, stated that an intention merely to carry over the true provisions of the previous deed was sufficient. The court also referred to Vos J's comment in *Industrial Acoustics Co Ltd v Crowhurst [2012] EWHC 1614 (Ch)* that there may be cases where the absence of any discussion between the parties about a particular change is sufficient evidence that they did not intend to make the particular change.

The court concluded that the claimant had made out a *"compelling case"* for rectification and granted the claimant summary judgment. Among other evidence, the court noted that the Plan had been administered on the basis that the actuarial reduction applied to Transferred Members, whether they were retiring from pensionable service or deferment (the additional liability to the Plan of providing the unreduced early retirement benefits would have amounted to £4.9 million on a technical basis).

Comment

This case will be of interest to employers or trustees seeking rectification of scheme documentation. In this case, the fact that the scheme's amendment power was unilateral meant that the court only had to consider the intention of the employer, not the trustees. On the facts of this case, the court concluded that the principles which apply to bilateral amendment powers are also applicable to unilateral powers of amendment. However, rectification cases are often very fact-specific and the judgment suggests that the case might be different in a situation where the employer and the trustees were not in agreement about the request for rectification.

PPF lodges appeal in relation to High Court's decision in Hughes v PPF

Summary

The Pension Protection Fund (PPF) has confirmed that it has lodged an appeal in relation to some of the High Court's judgment in *Hughes v Board of the Pension Protection Fund [2020] EWHC 1598 (Admin)*.

In June 2020, the High Court found that the PPF needed to ensure that members and survivors receive at least 50 per cent on a cumulative basis of the actual value of the benefits which their scheme would have provided to them. The PPF states that this is different to its understanding of the requirements under the EU Insolvency Directive (2008/94/EC) and would mean that the PPF would have to change its methodology.

Further detail

The two points which the PPF is specifically appealing are (i) the approach which the PPF may adopt to meet the requirement for members to receive 50 per cent of the value of their entitlement and (ii) how survivors' benefits should be calculated.

The PPF has also asked the Court of Appeal to allow it to wait until the appeals process is completed before it makes any changes to payments which would be required by the High Court's decision.

Separately, the DWP has lodged an appeal against the part of the judgment in which the High Court found that the compensation cap was unlawful.

Mr T (CAS-38354-V5L8): member compensated for loss of opportunity to invest following Brexit referendum, following High Court judgment

Summary

Following the High Court decision in *Tenconi v James Hay Partnership [2019] EWHC 2285 (Ch)*, the Ombudsman found that Mr T should be compensated for the loss of an investment opportunity which was caused by maladministration on the part of James Hay Partnership (James Hay).

Background

Mr T was a member of a small self-administered scheme. In March 2016, Mr T contacted James Hay to start the transfer of his pension to a new provider. Mr T repeatedly flagged to James Hay that he wanted the transfer to be complete before the Brexit referendum on June 23, 2016, so that he could invest it following the result. Some of the transfer was made in August 2016 but it was not completed until October 3, 2016. Mr T complained to James Hay that he had lost the opportunity to invest following the result of the Brexit referendum, which resulted in an initial fall in the FTSE 100 Index but the FTSE 100 had recovered by the time the transfer was made. James Hay rejected Mr T's complaint and Mr T referred the matter to the Pensions Ombudsman's office.

Ombudsman's decision – June 2018

The Ombudsman decided that, although there had been maladministration on the part of James Hay, the loss which Mr T was claiming for was *"neither measurable nor the exact nature of his investment within the reasonable contemplation of the parties"*, because there was no evidence of the specific shares which Mr T intended to purchase following the result of the referendum. The Ombudsman directed James Hay to pay Mr T £2000 for the very significant distress and inconvenience which he had suffered.

Mr T appealed to the High Court.

High Court's decision – *Tenconi v James Hay Partnership*

The High Court found that there were errors of law in the way in which the Ombudsman considered the issues of measurability of loss and foreseeability and the matter was remitted back to the Ombudsman for further consideration. In particular, the Ombudsman was to determine the date on which the transfer would have arrived had there not been maladministration on the part of James Hay.

Ombudsman's decision – September 2020

The Ombudsman decided that, were it not for the maladministration on the part of James Hay, the transfer would have been completed by June 23, 2016. The Ombudsman also stated that he considered that, on the balance of probabilities, Mr T would have invested the full amount of cash in the FTSE 100 Index immediately after the result of the Brexit referendum.

The Ombudsman calculated that, had Mr T been able to invest the cash immediately after the result of the Brexit referendum, he would have gained £43,700 in investment return. The Ombudsman directed that James Hay should pay this amount, plus interest at 8 per cent, to Mr T. As the Ombudsman had already awarded £2000 for distress and inconvenience, no further award was made.

Comment

Given the High Court's decision in *Tenconi v James Hay Partnership*, it was likely that the Ombudsman would reach a decision in favour of Mr T and require James Hay to compensate him for the investment loss which he suffered. It will be interesting to see how this decision affects future claims for investment loss; the Ombudsman's determinations are not binding but this decision may well carry some weight in deciding similar claims in the future.

Pensions issues in the pipeline

January 31, 2020 – The UK withdrew from the EU and the transition period will last until December 31, 2020.

New Pension Schemes Bill – The new Pension Schemes Bill includes provisions covering the Pensions Dashboard, the Regulator's powers, and the revised Funding Regime. The date for the Bill's second reading in the House of Commons is yet to be announced.

October 1, 2020 – New disclosure obligations apply for trustees in relation to scheme's Statement of Investment Principles under the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 following the transposition into UK law of the revised Shareholder Rights Directive (SDR II).

October 1, 2020 – New requirements for "relevant schemes" (broadly, money purchase schemes with 100 or more members) to publish an implementation statement and make it publicly available under amendments to the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013.

October 7, 2020 – closing date for government consultation on governance and reporting requirements for trustees in relation to climate risks and opportunities.

October 30, 2020 – closing date for government consultation on DC consolidation.

October 1, 2021 – New requirements apply for trustees to publish information on a publicly available, free website relating to voting and capital structure of investment companies under the Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations 2019 following the transposition into UK law of the revised Shareholder Rights Directive (SDR II).

October 1, 2021 – New requirements for trustees of DB schemes to publish an implementation statement online under amendments to the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013.

Revised Funding Regime – A revised Code of Practice is expected by the end of 2021, after the Pension Schemes Bill 2019/21 becomes law.

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