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NORTON ROSE FULBRIGHT

Pensions briefing

A review of the Pensions Regulator's recent activities

Updater

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Introduction

In this briefing, we have rounded up some of the recent publications, statements and guidance issued by the Pensions Regulator in recent months. Although the Government is still largely pre-occupied with Brexit, the Regulator has been far from idle. Below, we provide an overview of some of the highlights.

We anticipate a busy concluding few months to the year as the Government catches up with issues other than Brexit and publishes various pieces of legislation following the conclusion to consultations.

DWP advocates a new rule-making ability for the Regulator

In May 2019, the Department for Work and Pensions published a periodic, government-conducted tailored review which examined the continuing need, efficiency and good governance of the Regulator.

The review's two principal conclusions were

- The Regulator's current form remains the most appropriate for its functions, and the idea of a merger with the FCA was rejected. The two bodies regulate markets with different fundamental purposes and it makes sense to continue regulating them separately.
- Consideration should be given to extending the Regulator's powers enabling it to make its own rules in specific circumstances This would bypass the current need for changes to primary legislation, enabling the Regulator to be stronger and more proactive.

The headline-grabbing proposal that the Regulator could benefit from its own rule-making ability, is based on the DWP's conclusion that response to risks and changes in the pensions sector would then be more immediate, as *"the regulations themselves cannot change at the same pace as the digital world"*. The review stated that such an ability would aid the Regulator's strength and potentially resolve public confusion over the extent of its powers by facilitating its response to emerging risks. However, granting the Regulator rule-making powers would represent a dramatic change, and could lead to a reduction in accountability, with associated uncertainty for employers and trustees.

The genesis of the review was the Regulator being heavily criticised in 2018 by two Parliamentary committees over its work on Carillion and BhS, with the group of MPs saying that the Regulator made *"hollow threats"* and *"failed in all its objectives"*. We will be monitoring developments closely. The Regulator has, however, bounced back from this criticism with a raft of new initiatives.

The 2019-2022 corporate plan heralds "new regulatory initiatives" to improve member outcomes

Later in May 2019, the Regulator published its new corporate plan for the period 2019 to 2022, setting out its commitment to improving *"the participation, accountability, protection and confidence in occupational pension schemes"*.

The Regulator's intentions for this 3-year period include new initiatives aimed at increasing its engagement with schemes and future communication plans aimed at clarifying trustees' duties. Two initiatives were announced with the FCA

- The launch of a joint review of the *"consumer pensions journey"*, examining how the information disclosed by schemes and providers interacts with the guidance and advice services available to savers.
- Closer work with the FCA and the Money and Pensions Service on informing members of the risks involved in DB to DC transfers and the available options.

The Regulator confirms that *"action will be taken where standards are not met"*. DC schemes falling short will be encouraged to consolidate. In addition, a new, dedicated supervision team will oversee all types of scheme identified by the Regulator as needing closer oversight. One year on from announcing its intention to become *"clearer, quicker and tougher"*, these were both themes further examined by the Regulator in July 2019 in its annual report and accounts for 2018/19.

The corporate plan also confirmed further engagement with stakeholders and other regulators on the proposed revised DB code of practice, as well as focus on phase two of the 21st Century Trustee programme.

More on the expected DB scheme funding framework consultation

In a blog post, the Regulator confirmed further details of its approach to changes to its DB funding guidance, as outlined in the DWP's White Paper *"Protecting Defined Benefit Pension Schemes"*. The Regulator highlighted that further clarity was needed on the calculation of schemes' technical provisions and the setting of appropriate recovery plans, to prevent *"a minority of schemes and employers abusing the flexibilities in the system"*.

Although the Regulator's own annual funding statement analysis concluded that funding levels and deficits of schemes undertaking valuations as at 31 March 2019 (Tranche 14) had improved marginally over three years, the issues due to be addressed "this summer" (but not available to date) includeThe Regulator's consultation includes the following draft guides

- A clearer DB funding framework, with long-term funding targets including ideas on progressive reduction of reliance on the employer covenant for closed schemes, aiming to reach low dependency by the time they are *"significantly mature"*.
- For open schemes, a focus on meeting the LTFT without unduly increasing the cost of future benefit accruals.
- Proposals for clearer guidelines on acceptable lengths of recovery plans for different covenant strengths.

The key issue here was the emphasis on the LTFT for all schemes, with the Regulator noting that schemes' funding plans sometimes had an inappropriately short-term focus. In due course, legislation is expected to set out a requirement for DB schemes to have an ultimate objective, such as buy-out, consolidation or self-sufficiency, in line with the scheme's maturity profile. In advance of the new law and the revised DB funding code, TPR will expect all schemes to set a LTFT "journey plan" consistent with how the trustees and employer expect to deliver the scheme's ultimate goal, and to be able to show that their short-term investment and funding strategies are aligned with the LTFT.

A second consultation on the new draft funding code is due in 2020.

A future single Code of Practice?

The Regulator has also signalled a radical shake-up over the next year of its codes of practice and is reviewing the current line-up of its current 15 codes *"to form a single, shorter code"*. These changes are all part of the Regulator becoming clearer, quicker and tougher. The new overarching code will be introduced in phases, and its aim is to ensure that clear and consistent expectations are set for all types of scheme.

Again, consultation on this ambitious project is expected later this year. Anyone who has tried to navigate through the large number of codes, guides, statements, forms and research papers on the Regulator's website in order to ensure their scheme's compliance will wish the Regulator every success with its review and re-organisation. With such an enormous task ahead, it may be unlikely that any draft of the new, single code will be available before 2020.

Focus on DB schemes: Court of Appeal extends Regulator's "look back" period in *Box Clever case*

This Court of Appeal judgment, handed down on June 27, 2019, decided that the Regulator could look back to periods before its moral hazard powers were introduced under the Pensions Act 2004 in deciding whether to issue a Financial Support Direction.

ITV had appealed on the question of the retrospective scope of the legislation, but the Court held that there were no express time limits and that the law was "neutral" on the admissible factors governing the Regulator's decision on whether to issue an FSD.

In the most detailed ruling to date on this issue, the Court confirmed that FSDs may relate to events occurring before the introduction of the Regulator's powers. The *Box Clever* decision also provides guidance on the concept of reasonableness, establishing that it may be deemed reasonable to issue an FSD where a target has not received a benefit from the employer. The Court also said that the level of funding and resources of a target should be not be a consideration.

While the FSD does not itself impose financial obligations, ITV will be expected now to make plans for its future funding of the Box Clever scheme, with both the Upper Tribunal and the Court of Appeal having now confirmed that the broadcaster should provide the scheme with financial support. It is possible that this is not the last of the issue, as although the Court of Appeal refused ITV's request for permission to appeal, a direct application could still be made to the Supreme Court.

Focus on DC schemes: Regulator announces crackdown on reviews of DC default arrangements and updates its DC investment guidance

In June 2019, the Regulator was busy on the DC front. With more than 95 per cent of members of trust-based DC schemes saving in a default arrangement, the Regulator announced a new drive to ensure that DC trustees are properly governing default arrangements. Hundreds of DC and hybrid scheme trustees were contacted as part of a pilot scheme and asked to confirm that appropriate reviews had been conducted.

Schemes must review both their default strategy and the default arrangements' performance every three years, or when there is a significant change in a scheme's investment policy or membership demographic.

If a scheme's default strategy has not been recently reviewed, the Regulator will take trustees through simple steps to comply with the law. This will include reviewing the current strategy, taking members' needs into account and reviewing the performance of the default arrangement. The Regulator has stated that trustees struggling to meet the expected standards should consider the potential benefits of consolidation and whether value for savers would be improved by transferring them into an alternative and better run scheme.

The Regulator has published a significant revision to its DC investment guidance, which accompanies its DC Code of Practice. The guidance now covers the new investment requirements around financial and non-financial factors including environmental, social and governance considerations and policies. This ties in with the Regulator's declaration, issued jointly with other regulators, recognising climate change as a major issue. The guidance also reflects a much greater focus on documentation and reporting, establishing investment beliefs and priorities for investment decisions, value for money and better understanding of costs, trustees' own skills and performance, and the arrangements that trustees have with their asset managers.

New investment and disclosure duties will apply from October 1, 2019 and October 1, 2020, implementing pensions aspects of the Shareholder Rights Directive II. The Regulator's guidance now incorporates new requirements regarding pension schemes' statements of investment principles and the disclosure of information, as set out in new regulations.

Two new consultations ...

... one on trustee guidance following the CMA's investment consultancy recommendations

On the back of a DWP consultation on new draft amending regulations, in **August 2019**, the Regulator consulted on new guides intended to assist trustees in managing their responsibilities on the appointment and retention of investment consultancy and fiduciary management services. The consultation closing date is September 11, 2019.

The new regulations will require trusts to conduct a selection process when appointing a fiduciary manager. Trustees will also be required to set specific strategic objectives for their investment consultancy service providers to enable them to better manage performance and to monitor value for money more closely.

The Regulator's consultation includes the following draft guides which include illustrative case studies

- **Tendering for fiduciary management services** – This guide provides a set of key principles to illustrate good practice to tendering and how an explanation of the principles may be applied.
- **Tendering for investment consultancy services** – This shorter guide outlines how the key principles of a competitive tender may be applied to a tender for investment consultancy services.
- **Setting objectives for providers of investment consultancy services** – This guide addresses how trustees can set objectives in line with the draft regulations.
- **Choosing an investment governance model** – This guide sets out the relevant matters for trustees to consider and is aimed at assisting trustees to understand investment governance.

...and the second on forcing higher standards on trustees

On July 2, 2019, the Regulator issued a consultation paper on the *Future of trusteeship and governance*. It is wide-ranging, contemplating the following future aspirations

- Raising the standards required of all professional trustees (whether accredited or not) and requiring all trustee boards to have an accredited professional trustee/trustee director.
- Changing the Trustee Knowledge and Understanding Code of Practice to introduce competency-based standards, for example, through relevant training or qualifications plus a continuing professional development structure.
- Greater contact with schemes to require trustees to demonstrate how they meet TKU requirements and other regulatory initiatives (that is, via direct contact with trustees) testing investment governance, record-keeping, and promptness and accuracy of financial transactions, costs and charges.
- Encouraging consolidation of schemes where trustees are persistently unable or unwilling to meet the expected standards, including via investigations and enforcement measures.
- A greater focus on and support for diversity in recruitment of trustees, requiring trustees to report on trustee board diversity (but without forcing quotas on boards).
- Digging deeper into potential issues with sole trustees.
- Improving routes to wind-up to avoid members losing the benefit of guarantees.

The consultation closes September 24, 2019.

Meanwhile, work on auto-enrolment continues...

The Regulator has launched a new online re-enrolment tool to enable employers to re-enrol their staff into a workplace pension more simply. While the vast majority of employers are carrying out re-enrolment successfully, some are failing to complete the task correctly - which could lead to a fine. The new re-enrolment tool was launched as thousands of small and micro employers were due to reach their re-enrolment dates.

Even if employers do not have staff to re-enrol, they must still complete their re-declaration of compliance to confirm they have carried out the relevant check.

Comment

The Regulator has clearly been busy and is setting expectations now in advance of any legislation that may appear in 2019. Central to these expectations is the issue of a revised DB funding code of practice and the LTFT. The LTFT is distinct from, and sits above, the scheme's technical provisions. It will need to be considered for all schemes (not just those in Tranche 14) ahead of the appearance of the revised DB funding code, whenever that may be.

More generally, following some bruising criticism from Parliamentary committees on the functioning of the pensions industry, with Frank Field MP suggesting that *"ripping off pension savers could be eliminated"*, it is clear that the Regulator is taking seriously its role of being *"clearer, tougher and quicker"*. That said, we have seen no further mention of the Regulator's new *"rule-making ability"* which was proposed in the DWP's tailored review in May 2019.

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