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Essential pensions news

Updater

March 2019

Introduction

Essential pensions news covers the latest pensions developments each month.

The next event in our client seminar programme for 2019,*"To buy-out, buy-in or consolidate? That is the DB question …"* takes place at Norton Rose Fulbright offices from 8.30am on Thursday May 9, 2019. To reserve a place, please register.

The Pensions Regulator's annual funding statement 2019

On March 5, 2019, the Pensions Regulator (TPR) published its latest annual funding statement. The statement is aimed at trustees and sponsoring employers of defined benefit (DB) schemes with valuation dates between September 22, 2018, and September 21, 2019 (referred to by TPR as tranche 14, or T14, schemes). However, given its wide implications, the statement is relevant to all DB schemes, and its contents should be noted particularly where schemes face significant changes and, as a consequence, require reviews of their funding and risk strategies.

The key themes from TPR for this year are

- The introduction a long-term funding target (LTFT) for all schemes, not just those in T14.
- Balancing risks and the segmentation of schemes by maturity as well as by covenant strength.

- What TPR expects from trustees and employers in terms of the scheme's LTFT and balancing risks.

- TPR's approach regarding the scheme's equitable treatment in comparison with other stakeholders. Concern remains over the disparity between dividend growth and contributions and other forms of what TPR terms covenant "leakage" (by which it means value leaving the sponsoring employer).

For further detail, please see our March 2019 briefing, which looks in depth at each of TPR's key messages, compares them with some of the themes in TPR's earlier statements, and suggests some action points for trustees and employers engaged in or approaching a valuation.

Comment

In a publication that has become something of an annual convention, TPR's latest statement delivers a more detailed analysis of its view on the general DB funding picture than those of past years. The statement is essential reading for all trustees and employers, not merely those in T14 undertaking valuations this year. The LTFT requirements are more far-reaching than funding considerations set out in previous statements, and exceed the technical provisions funding basis. Although the LTFT does not yet have legal force, TPR expects employers and trustees now to have in mind the delivery of their scheme's ultimate objective.

TPR has given clear indications of how it envisages its powers and their usage developing in the immediate and short-term future and all those involved with DB schemes should take heed. There is also an explicit warning that TPR it will commence formal investigations where necessary and appropriate, which is a clear reminder of TPR's intention to be a "clearer, quicker and tougher" regulator.

As for actions to be taken in the short term, trustees and employers need to take advice from their actuary on the level of scheme maturity. Consideration must also be given to which of the ten categories of risk level applies. A LTFT will need to be devised which is consistent with the scheme's end-goal and discussions should be held on how to address any recovery plan which may now be considered excessively long. Forms of "covenant leakage" affecting the scheme's funding position may attract unwanted attention from TPR and trustees and employers should be able to evidence robust negotiations, and should be prepared to justify their decisions and approach. It is likely that the new DB funding code will "up the ante" still further and it will need to be read closely when it is available for consultation later this year.

View the funding statement.

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

Spring Statement light on pensions news

On March 13, 2019, Philip Hammond presented his Spring Statement. Although the Statement itself did not mention pensions, the related documents touched on a few areas of indirect importance to schemes

- As announced in the Budget 2018, the Treasury has launched a consultation on establishing a framework for private investment in infrastructure, the light of the UK's imminent departure from the EU. The consultation's closing date is June 5, 2019.
- Also following a Budget announcement, the Treasury's Debt Management Office confirmed plans to reduce index-linked gilt issuance, with the total due to fall by one or two per cent in 2018/19 and 2019/20.
- The Government will respond in April 2019 to the report published in January 2019 by the House of Lords' Economics Affairs Committee which criticised the use of RPI as the measure for UK price inflation. The report recommended correcting immediately the error arising from the "clothing/formula" effect in the RPI, which could reduce the annual inflation measure by at least 0.3 per cent in the long term.

Comment

It was something of a surprise that the Spring Statement went ahead at all at the time it did, given the Brexit mire in which Parliament still finds itself drowning. With the Chancellor having made his speech as planned, it is less of a surprise that there were no substantial announcements, given the other matters commanding the Government's attention.

Green light for CDC schemes – Government confirms intention for legislative framework to proceed

In a consultation response published on March 18, 2019, the Government has confirmed that it intends to legislate to provide a framework for single and associated employer collective defined contribution (CDC) schemes "as soon as parliamentary time allows", and consider further what other future provision may be appropriate.

The consultation response sets out the Government's CDC proposals, and its view that new primary and secondary legislation will be required. CDC benefits will be classified as a type of money purchase benefit to give employers the assurance they need that CDC schemes will not give rise to future employer funding liabilities to the scheme. The consultation also notes that effective member communication will be critical for members to understand their CDC benefits.

The consultation asked detailed questions about how CDC schemes might operate, drawing on the recent experience of Royal Mail in working towards establishing such a scheme. However, legislation for the general availability of CDC schemes will not be drafted until the Royal Mail CDC scheme is properly established, at which point the DWP will begin working with interested parties on legislation for wider CDC models.

The intention is for CDC schemes to be authorised and overseen by TPR, in a similar way to the DC master trust regime which is currently underway. The plan is for members of CDC schemes to have access to the pension freedoms introduced in 2015 and the annual charge cap is due to match that for DC default funds – 0.75 per cent. HMRC will consult in due course on the technical details relating to proposals for the application of tax relief on contributions, as currently enjoyed by members of DB and DC schemes.

Comment

The DWP intends to bring forward legislation to provide a framework for CDC schemes "as soon as parliamentary time allows", so it is difficult to predict when this might appear on the Government's immediate "to do" list. It is possible that the draft primary legislation may be included in the Pensions Bill 2019 due this summer. Once the Royal Mail scheme has been established, the Government intends to begin working with interested parties to develop an operational and legislative framework for other models, but it seems unlikely that CDC schemes will be widely available before the mid-2020s.

However, a slow and measured approach is no bad thing as a number of questions remain answered – such as how the pensions tax regime will apply and how CDC schemes will qualify for auto-enrolment. CDC schemes represent a significant change from the UK's current binary system, in which schemes operate on a defined contribution or defined benefit pension basis. The CDC option will be welcomed by employers as a way of managing their pension exposure and the Government is confident that CDC schemes could also benefit members.

The Government recognises that one of the key issues will be the way in which complex CDC benefits are explained to members. Members will need to be given sufficient information to understand CDC schemes. This is particularly relevant to the necessary risk warnings on how pensioners' benefits might be subject to future change, as they cannot be guaranteed.

TPR publishes guidance on winding up DC schemes

TPR has published guidance for trustees and employers engaged in winding up occupational defined contribution (DC) pension schemes, setting out the four key steps that need to be taken

- Deciding whether the scheme should be wound up – this section looks at who has the power to trigger the winding-up of the scheme and situations in which such action might be appropriate.

- Preparing for and entering the formal winding-up of the scheme – TPR emphasises the importance of planning in advance, developing a project plan, engaging with advisers, and cost-planning. It sets out how to trigger the winding-up and suggests contents for the preliminary communications with members, including how their benefits will be affected and who to contact.

- Securing members' benefits – focus is given to the main tasks for trustees and administrators in ensuring that the scheme can secure members' benefits (for example, does the scheme have sufficient member data, what are the trust powers), and considering the options available (such as buyout, transfers out or benefit crystallisation). The guidance notes that these often occur simultaneously.

- Completing the winding-up process – once the members' benefits have been secured, trustees should consider whether indemnities and insurance are needed, complete documentation to formalise the wind-up, notify TPR and HMRC, finalise the scheme accounts, close the trustees' bank account, and finalise an announcement to members.

- TPR notes that the guidance does not replace the need for professional guidance, but trustees may find it useful to establish which actions they can take before seeking professional help.

View the guidance.

Court challenge to PPF's *Hampshire* ruling implementation approach

In September 2018, the European Court of Justice ruled in the *Hampshire* case that pension scheme members being paid compensation from the Pension Protection Fund (PPF) are entitled to an "individual minimum guarantee" of 50 per cent of the value of their entitlement to old-age benefits, rather than an average level of pension protection. In our January 2019 update, we noted that the PPF was first assessing the position of members subject to the long-service cap, after which it planned to deal with members subject to the standard compensation cap. Finally, the position of all remaining members was to be considered, including those yet to start drawing benefits.

In a further update, the PPF has now revealed that its approach is being challenged in the High Court and, according to a frequently asked questions document, the PPF intends to undertake a one-off calculation for affected members. This will assess the total actuarial value of the member's scheme benefits payable from their employer's insolvency date (using their original scheme benefit structure) and compare it against the total actuarial value of their PPF benefits payable from the same date. If the latter is less than 50 per cent of the former, the PPF will increase the member's PPF benefits until the 50 per cent threshold is met. No further adjustments will be made to reflect subsequent events. Interest will be payable on arrears at Bank of England base rate.

Comment

No further information is yet available about the court proceedings, or the exact details of the challenge. While the PPF says it considered whether to suspend its implementation work in light of the case, it has resolved to continue with its current approach for the time being, but to limit the size of arrears payments to reduce the prospect of overpayments having to be recovered from members if the court decide a different calculation approach should be adopted. The process is due to be kept under review pending further developments.

The PPF has published an online FAQ document and further queries should be sent to its new email address: information@ppf.co.uk.

Single Financial Guidance Body renamed Money and Pensions Service

The former Single Financial Guidance Body has been renamed the Money and Pensions Service and will be known by its new name from April 6, 2019.

Under the Financial Guidance and Claims Act 2018 (Naming and Consequential Amendments) Regulations 2019, make further consequential amendments to the 2018 Act to reflect the new body's name and functions.

Comment

Trustees should note that any member communications or other scheme documents that direct members to the Money Advice Service, the Pensions Advisory Service or Pension Wise will need to be updated to reflect the new name.

Publication of Standards for Professional Trustees

On February 25, 2019, the Professional Trustee Standards Working Group published a new set of standards and an accreditation framework that professional pension trustees will be expected to follow.

Professional trustees will have to first pass an initial application process to gain accreditation run by the PMI, which will require compliance with a "fit and proper" requirement modelled on that for trustees of master trusts and the provision of two references from reputable figures within the pension industry. They will also need to successfully complete TPR's trustee toolkit and an online soft skills test designed to test the "other Professional Trustee skills and behaviours" associated with professional trusteeship (which is yet to be developed).

In order to maintain accredited status, trustees will need to complete an annual attestation confirming that they remain "fit and proper", that they continue to meet to the required standards and that they have completed any new modules in TPR's toolkit. In addition, they will need to complete 25 hours of relevant CPD, at least 15 of which must be structured (such as a formal seminar, conference or training session).

The standards apply to professional trustees on an individual basis rather than at trustee firm level. They therefore do not cover organisational aspects (for example systems, controls and professional indemnity insurance) which may be applicable at firm level.

Additional standards must be met by those who act as the chair of a trustee board or who are sole trustees. Further details are expected by mid-2019.

Comment

Professional trustees are becoming increasingly common as pensions legislation and governance grow more complex, and the publication of the standards follows an extensive period of consultation. Input from respondents has been seen as invaluable in shaping the final version of the standards and the initial proposals were extensively reviewed following the comments received. Changes made include scrapping the "comply or explain" principle in favour of requiring professional trustees to comply fully with the accreditation system. The drive to raise standards has been welcomed by the industry generally and is designed to improve the quality of professional trustees and discourage poor practices in the market.

TPR has hailed the new standards as a robust accreditation framework which will help to ensure that professional trustee appointments are high quality and meet the expected standards. The PMI sees running the accreditation process as a natural extension of its work promoting excellence in pensions and looks forward to playing a key role in this initiative to drive up standards.

Once the online soft skills test has been finalised, professional trustees will be able to begin the accreditation process, and the completed framework is expected to be launched later this year.

FCA publishes letter on misleading promotions of defined benefit to defined contribution transfers

On March 22, 2019, the Financial Conduct Authority (FCA) published a "Dear CEO" letter concerning managing the risks of defined benefits to defined contribution transfers.

The letter explains that over the past year the FCA has carried out work to evaluate and reduce the risks of harm to consumers arising from the transfer of funds from their DB schemes to DC products.

The FCA reports that it has now completed its review of pension product providers and identified key drivers of harm. The FCA sets out in the Dear CEO letter its expectations as to what firms need to consider when designing, marketing and providing pension products. These fall within the following categories

- Product design and target market.
- The information given to distributors.
- FCA permissions procedures.
- Management information.
- Remuneration structures.
- Governance and risk management.
- Documentation and tools.

The letter reminds regulated firms about their obligations when communicating with clients, and strongly encourages them to review their websites and financial promotions. The FCA had discovered several instances where firms' promotions gave the impression there was blanker UK authority regulation of their product suite when that was not the case. This meant that some unregulated services were being sold to investors inappropriately, as the assumption was that they were FCA-supervised.

The FCA expects providers to gain assurance that they have appropriately implemented and fully comply with the recommendations and guidelines issued by the FCA.

HMRC publishes Countdown Bulletins 43 and 44

Countdown Bulletin no. 43 was published on March 1, 2019 and includes the following

- Pension Scheme Administrator (PSA) queries - although the submission date for queries relating to the Scheme Reconciliation Service (SRS) has passed, the Countdown Bulletin will continue to provide guidance until scheme reconciliation activity is complete. The contact address is CRM.schemereconciliationservice@hmrc.gsi.gov.uk in all instances.
- PSA guidance is now available for trustees and administrators of DB schemes which are responsible for contracted-out entitlements built up before April 6, 2016.
- Ywo SRS process changes have been introduced which should help HMRC increase its rate of production: similar queries will be worked on in bulk basis; and the final outputs sent after SRS ends will confirm individual Guaranteed Minimum Pension (GMP) amounts.

View Countdown Bulletin no. 43.

Countdown Bulletin no. 44, published on March 5, 2019. Includes

- Countdown Bulletin no. 42 advised that for schemes in deficit following HMRC's financial reconciliation, letters would be sent by the week commencing April 15, 2019. This date has been revised to April 1, 2019. The payment still needs to be made by the original date of May 21, 2019 at the latest.
- The scheme financial reconciliation date has been brought forward, meaning that for schemes which have more than £1,000 deficit, HMRC will write off debt that was raised before March 4, 2013, which is six years before the new run date.
- Provision of various links to past countdown bulletins and guidance on the end of contracting-out.

View Countdown Bulletin no. 44.

HMRC newsletter 107: reminder of deadline for master trust authorisation applications but extension possible

On February 27, 2019, HMRC published edition 107 of its regular pension schemes newsletter. The newsletter highlights several issues of relevance for administrators.

The key point of interest is a reminder from HMRC that the closing date for applications to TPR for authorisation of a master trust is March 31, 2019. If the master trust has not applied for authorisation by this deadline and continues to operate, TPR may issue a fine and the scheme may be required to exit the market.

However, on March 21, 2019, TPR published a blog on its website highlighting the possibility of master trusts applying for an extension to the authorisation deadline where trustees have a good reason.

Two main reasons which TPR will consider are

- Where there is a key change to a scheme, such as a new owner, administrator or trustee.
- That TPR is encouraging those filing authorisation applications in the last two weeks of March to also apply for an extension. TPR is keen that schemes file the best possible application for authorisation, and this ensures that schemes can send in any additional information which TPR may request after the March 31, deadline.

View Pension schemes newsletter 107.

Mr H (PO-20991): ill-health early retirement – complainant could not rely on disability discrimination by association in eligibility assessment

The Deputy Pensions Ombudsman (DPO) has dismissed a complaint by a member of the Local Government Pension Scheme who argued his employer discriminated against him by awarding him second-tier ill health early retirement benefits on the assumption he would be able to undertake gainful employment in the 19 years remaining until he reached normal pension age. The complainant maintained the employer's decision amounted to indirect discrimination by association on grounds of disability, on the basis he had caring responsibilities for his disabled son.

The DPO held that the employer had correctly awarded the member second-tier benefits and had applied the guidance and governing regulations in accordance with the Equality Act 2010 and not in a discriminatory way. She held that the claimant could not rely on indirect discrimination under the Act because there was no right in UK law to be protected from indirect discrimination by association on the grounds of disability.

It was the complainant's own medical condition that was relevant to an assessment of his capability to undertake gainful employment, not the disability of an associated third party. Nor was there any basis for arguing the employer was under a statutory duty to make reasonable adjustments to the gainful employment criterion that applied when considering eligibility for ill-health benefits. A claim for reasonable adjustments on the grounds of disability could not arise from discrimination by association. The employer was not obliged to make reasonable adjustments to accommodate the complainant's caring responsibilities for his son.

Overall, there was no evidence of discrimination in the employer's decision, or any flaw in its decision-making process. The evidence showed the employer gave full and proper consideration to the complainant's medical condition and the impact of his caring responsibilities and other family matters on his own health.

Comment

Discrimination by association is a complex (and developing) area of the law, and the position may not be quite as clear as the DPO suggests in this determination.

In *Chez Razporedelenie Bulgaria*, (a case which was considered here by the DPO) the ECJ held that an indirect discrimination claim could be brought by a person not possessing the protected characteristic. While the ECJ decision expressly concerned the Race Directive, some have commented that the reasoning could apply to other areas of discrimination law.

The ECJ noted that the language of the Race Directive was not decisive and should be interpreted with regard to its overarching aim of eliminating all discrimination on ethnic or racial grounds. The Equal Treatment Framework Directive similarly aims to prohibit direct or indirect discrimination based on the protected characteristics referred to (including disability), and it is arguable that the ECJ would not wish to see individuals with protected characteristics precluded from bringing a complaint. If this reasoning is correct, it is possible that a High Court could succeed.

Pension developments in the pipeline

Below is a summary of pension changes expected in the near future in addition to those outlined above. Changes since the last update are italicised

- March 29/*April 12/May 22* – the UK withdraws from the EU, although it is (currently) unclear exactly what form Brexit will take.
- March 31 – Master Trust authorisation application deadline *unless an application has been approved by TPR for an extension*.
- March 31 – scheme return and PPF deadline (effectively March 29 as March 31 is a Sunday).
- March 31 – GMP reconciliation deadline for HMRC queries.
- April 6 – increases to auto-enrolment contributions.
- October 1 – new SIP requirements in force relating to environmental, social and governance (ESG) factors.

DB consolidation and superfunds – consultation closed February 1, 2019.

CDC schemes – *consultation response published March 18, 2019*.

Pensions dashboard – the Government says “tremendous progress” is being made.

Pensions Regulator’s powers – DWP response to consultation published February 11, 2019. *TPR’s annual funding statement detailing new long-term funding target published March 5, 2019*.

New Pensions Bill is due in Summer 2019 covering “multiple areas of pensions law”, including DB consolidation and CDCs.

EMIR – new requirements to the exchange variation margin relating to derivatives applied from March 1, 2017. A further EMIR temporary exemption extension for pension scheme arrangements applied to August 16, 2018 and has now expired. In the absence of a further temporary exemption, ESMA expects national competence authorities not to prioritise their supervisory actions towards entities that are expected to be exempted again relatively shortly. The UK Government has confirmed that, as far as possible, the regime set out in the EMIR legislation will not change after the UK has left the EU.

The DC scheme Chair’s annual governance statement – this must be completed within seven months of the end of the scheme year. For example, schemes with a March 31 year end should have submitted the statement by October 31, 2018. TPR issued trustee guidance on the statement in November 2017 and the guidance was updated in June 2018 and further in September 2018.

IORP II – the transposition date was 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.

New regulations – the Occupational Pension Schemes (Administration and Disclosure) (Amendment) Regulations 2018 came into force April 6, 2018 setting out new requirements to improve transparency on DC benefit costs and charges to members. They do not apply to DB schemes providing only DC AVCs. Members must be provided with access to information via a website with 7 months of the scheme’s year-end date – meaning the earliest date was November 2018 for schemes with year-end April 6, 2018.

VAT – HMRC’s existing practice on VAT and pension schemes is to continue indefinitely. Employers should consider taking steps to preserve (or enhance) their pensions-related VAT recovery.

Auto-enrolment – cyclical re-enrolment now applies within a six-month window related to the employer’s staging date. e.g. employers with a July 1, 2015 staging date must complete the cyclical re-enrolment process between April 1, 2018 and September 30, 2018. Total minimum contributions were increased to five per cent (of which minimum employer contribution of two per cent) from April 6, 2018. Total minimum contributions will increase to eight per cent (of which minimum employer contribution of three per cent) from April 6, 2019.

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