NORTON ROSE FULBRIGHT

Essential UK Pensions News

October 2020

Introduction

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

PPF consults on changes to the levy methodology for 2021/22

The Pension Protection Fund (PPF) is consulting on its draft levy determination which contains its proposed methodology for calculating levies for the levy year 2021/22.

The consultation is clear that it is not "business as usual"; there are a number of significant changes from the usual process, due to the effects of the COVID-19 pandemic.

One point to note is that the PPF is proposing a change to its normal approach of adopting rules which will remain unchanged for three years. The consultation envisages adopting a more flexible approach and reviewing the rules on an annual basis. This would enable the PPF to change its approach in 2022/23 once the economic effects of the COVID-19 pandemic have become clearer and also to reflect any changes in its funding position. The PPF envisages returning to reviewing its levy rules every three years (or longer) from 2023/24.

The consultation contains two proposed policy changes for the levy year 2021/22:

1. The (uncapped) risk-based levy for small schemes with liabilities of less than £20 million will be halved, with the reduction tapering away for schemes with liabilities between £20 million and £50 million;
2. The level of the cap on the risk-based levy will be reduced from 0.5 per cent of liabilities to 0.25 per cent of liabilities.

However, the PPF has not ruled out increases to the levy in 2022/23, depending on its claims experience over the next year and the outlook for its funding position.

With these two policy changes (and no alteration to the levy parameters), the PPF expects to collect £520 million in levy payments (in contrast to the estimated £620 million in 2020/21).

The consultation document also seeks views on whether the temporary extension to payment terms should continue for the levy year 2021/22. This year, it has been possible for schemes or sponsoring employers to apply for an extension from 28 days to 90 days for payment of the levy invoice, where they have been negatively impacted by the COVID-19 pandemic.

The consultation runs until November 24, 2020 and the PPF expects to publish its response early in 2021.

Comment

The significant changes in this year's levy determination are a response to the challenges for employers due to the COVID-19 pandemic. The switch to a yearly levy determination for the immediate future will mean that the PPF can respond more easily to changes over the next few months, given the current economic uncertainty.

Pension Schemes Bill enters committee stage

The Pension Schemes Bill 2019-21 finished its second reading in the House of Commons on October 7, 2020. On October 20, 2020, the government published its proposed amendments which will reverse changes made by the House of Lords during the report stage, including in relation to the pensions dashboard and collective money purchase schemes. The Bill now enters the committee stage, which is expected to be completed on November 5, 2020. Guy Opperman, Minister for Pensions and Financial Inclusion, has stated that he expects that the Bill will come into force by the end of 2020.

The government is offering the opportunity for people with relevant expertise and experience to submit their views on the Pension Schemes Bill. It is advised that any written evidence is submitted as soon as possible.

Pensions Regulator publishes its 15-year provisional corporate strategy

On October 16, 2020, the Pensions Regulator published its provisional corporate strategy for the next 15 years. The closing date for comments is December 16, 2020 and the Pensions Regulator will publish its strategy in the new year.

The document looks at the different pensions needs for different generations, namely Baby Boomers (who most commonly saved in DB schemes), Generation X and Millennials (who will mostly save in DC arrangements). The Pensions Regulator discusses this shift in pensions saving from DB to DC arrangements, particularly for younger generations and accelerated by the success of auto-enrolment, and is seeking to reflect this shift in its strategy over the next 15 years.

The document sets out the proposed five strategic priorities for the Pensions Regulator over the next 15 years:

- Ensuring savers' money is secure
- Ensuring savers get good value for their money
- Ensuring decisions made on behalf of savers are in their best interests
- Embracing innovation and encouraging he market innovates to meet savers' needs
- Providing bold and effective regulation.

In relation to the security of benefits in DB schemes, the Pensions Regulator *"will encourage the simplification of DB schemes, work with the market on alternatives to 'traditional' schemes and drive consolidation where this is in savers' interests."*

The introduction summarises the Pensions Regulator's approach as follows:

"The shift to DC means savers carry the financial risk on their investments as no set income is promised by these schemes. Savers' outcomes are therefore dependent upon the right contributions being made at the right time, being invested in the right place, and that their savings are not eroded by high costs and charges or poor performance. The decisions that determine these factors will largely be made by others.

Our focus must change from a scheme-based view to one that puts the saver at the heart of all that we do. This strategy centres on our commitment to pension savers.

For savers in retirement or entering retirement over the next 15 years, we will focus on protecting their savings outcomes so that money built up over a lifetime of saving is secure.

For savers that are further away from retirement, we will focus on driving participation and enhancing the outcomes they get from their pensions.

This will not be an overnight change for us. There is still much to do to secure the outcomes for members of DB schemes, both open and closed. Equally, as the automatic enrolment-driven system matures we must increasingly focus our efforts on ensuring that it delivers good quality outcomes for savers. We will therefore need to carefully balance our focus to ensure we take the right actions at the right time where we can make the most difference.

We will take a system-wide view of our regulation of pensions to make sure that money goes into pensions when it should, that it is well looked after and delivers value, and that savers can make good decisions and are protected when it comes to taking their money out."

DWP issues call for evidence on alternative quality requirements for defined benefit and hybrid schemes

Summary

The Department for Work and Pensions (DWP) is carrying out its latest three-yearly review of the alternative quality requirements for defined benefit and hybrid schemes to qualify for auto-enrolment purposes and has issued a call for evidence inviting views on this issue.

Background

The Secretary of State is under a statutory duty to review the alternative quality requirements for defined benefit and hybrid schemes under section 23A(1) of the Pensions Act 2008. Broadly, the alternative quality requirements are designed for employers who do not use "qualifying earnings" (annual earnings between £6,240 and £50,000 for 2020/21) to calculate contributions. These reviews must take place at least every three years and the last review was carried out in 2017.

The overarching aim of the review is to understand to what extent the regulations are operating as intended, including whether there are any unintended consequences, and to what degree the provisions are continuing to deliver simplifications and efficiencies for employers and pension schemes.

Call for evidence

The call for evidence is seeking views on three questions:

- Are the alternative quality requirements for defined benefit and hybrid schemes continuing to deliver the intended simplifications and flexibility for sponsoring employers and pension schemes that are unable to use the test scheme standard?
- In practice, who is carrying out the tests in relation to the alternative quality requirements (the employer (i.e. self-certification) or its professional advisers)?
- Is there anything sponsoring employers or pension schemes want to bring to the DWP's attention about the operation of the alternative quality requirements, in particular regarding previously unforeseen issues when compared to the test scheme standard?

The consultation closed on October 21, 2020.

DWP launches cross-sector working group to help address issue of small pension pots

On September 22, 2020, Guy Opperman, Minister for Pensions, announced the launch of a cross-sector working group to look into the challenges posed by the issue of small pots (i.e. where an individual's pension savings are fragmented between several small deferred pension pots).

The working group will report later in the autumn of 2020 with initial recommendations and an indicative roadmap of actions.

Comment
The issue of small pension pots has been a concern for the industry and has been particularly exacerbated by the success of auto-enrolment. We await the working group's recommendations with interest.

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

The PPF has published its response to the government's consultation on the reform to the RPI methodology. The response describes the following impacts on the PPF and the schemes it protects:

- The proposed change to the construction of the RPI index will cause the value of the PPF's inflation hedging assets to fall with no corresponding change in its liabilities. If the change takes effect in 2030, the PPF estimates this negative balance sheet impact will be in the region of £1 billion, increasing to £1.3 billion if the change is implemented in 2025.
- Members in schemes where benefits increase in line with RPI will see a significant reduction in the value of their pension over their lifetime.
- The impact on defined benefit pension schemes' funding will vary from scheme to scheme, depending on their circumstances. However, overall, the PPF expect the impact on defined benefit scheme funding to be "severely negative". It estimates there would be a negative impact in the region of £25 billion to £35 billion if the changes take place in 2030, which would increase to £55 billion to £65 billion if the implementation were brought forward to 2025.

The PPF also raises the possibility that there could be legal challenges to the change brought by or on behalf of investors *"either seeking for the change to be reversed or some mitigation for the losses it causes".*

The PPF concludes that it believes that *"the Government should do what it can to reduce the negative consequences of this change. In the context of this consultation that would mean refusing permission for the change to be introduced earlier than 2030."*

Comment
The PPF is another industry body which has called for these changes not to be made before 2030. It also raises the possibility that there could be future legal challenges by affected parties in relation to the government's decision to implement these changes.

Government announces new job support scheme

On September 24, 2020, the Treasury announced a new job support programme which will be introduced from November 1, 2020 *"to protect viable jobs in businesses who are facing lower demand over the winter months due to coronavirus".*

The scheme, which will run for six months, will be available to employees who are working at least 33 per cent of their usual hours. Employers will pay for the hours the employees work, but for the remaining hours not worked, the government and the employer will each pay one third of the employee's equivalent salary (subject to a cap).

The government will not cover national insurance contributions or pension contributions which will be payable by the employer. Details about how pension contributions should be calculated under this scheme have not yet been published, although it is expected that the Pensions Regulator will provide guidance on this shortly.

HMRC announces extension to temporary changes to pension scheme processes due to COVID-19 pandemic

In its most recent newsletter, HMRC has announced that it will extend certain temporary changes to pension scheme processes where schemes face difficulties due to the COVID-19 pandemic from the end of October 2020 until March 31, 2021.

Between March and June 2020, HMRC announced several relaxations in certain pension scheme processes where schemes' ability to comply with requirements had been affected by the COVID-19 pandemic. These temporary changes included reporting transfers to QROPSs to HMRC (HMRC confirmed that it would cancel any penalties relating to late reporting), filing pension scheme returns (HMRC said that it would not issue any notices to file scheme returns) and relaxing the requirements for certain types of documents to contain signatures.

PPF publishes response to Pensions Regulator's consultation on new DB funding code

The PPF published its response to the Pensions Regulator's consultation on the DB funding code on October 1, 2020.

Broadly the PPF is supportive of the proposal for a statutory requirement for all schemes to have a long-term funding objective and of the Pensions Regulator's guidance which dovetails with this.
The PPF comments that a sponsor's covenant can deteriorate rapidly and is visible for at most five years, meaning that a strong covenant at the moment provides *"limited comfort".* The PPF's view is that *"scheme reliance on future payments from sponsors through long recovery plan lengths, combined with significant back ending of DRC payments, presents a significant risk to members and the PPF and the challenging immediate environment due to COVID-19 should not be allowed to de-rail fundamentally sound proposals".*

In relation to the proposed approach to the regulation of scheme funding, the PPF is supportive of the Pensions Regulator's proposals, describing them as *"well thought through and helpful"* and noting that *"critically, the structure includes clear, objective standards against which schemes can be assessed".*

In relation to the long-term funding objective, the PPF believes schemes and employers should be seeking to reach and maintain a funding level which protects members in the event of an insolvency. This does not necessarily need to be a buy-out level but one where *"any losses to members are constrained to acceptable levels".* The PPF is also concerned about protecting its own position and reducing the number of likely claims, particularly in a context where the revenue from its levy is expected to diminish substantially.

The PPF also sets out detailed responses to the technical points raised in the consultation.

Pensions Regulator updates COVID-19 guidance on defined contribution (DC) scheme management and investment

The Pensions Regulator has updated its COVID-19 guidance on DC scheme management and investment in relation to the issue of the temporary closure of funds and inadvertently creating a default arrangement.

Some members of DC schemes have self-selected investment in funds (for example, property funds) which were temporarily closed (or "gated") as a result of the market volatility due to the COVID-19 pandemic. Some trustees decided, in these circumstances, to redirect contributions into alternative funds until the gated funds reopened. There was a risk that this could result in the alternative funds becoming default arrangements and therefore subject to legal requirements such as the charges cap or requirements in relation to statements of investment principles.

In June 2020, the Pensions Regulator updated its COVID-19 guidance to address this issue and it has now provided further updates to the guidance on the redirection of contributions back into the original fund when it reopens. The updates relate to when a pre-existing expression of choice is likely to still apply and when additional member consent may be required to redirect contributions back into the original fund.

PLSA publishes final recommendations on DC decumulation

The Pensions and Lifetime Savings Association (PLSA) has published its final recommendations on DC decumulation.

The report recommends that the government should introduce a new regulatory regime which includes:

- A new statutory obligation for schemes to support members with decumulation decisions;
- Three key elements in relation to this support: (i) member engagement and communications (ii) providing or sign-posting decumulation products and (iii) scheme or governance processes relating to the design or selection and delivery of these;
- A set of minimum standards for each key element; and
- Guidance to help schemes deliver the key elements and to work within the standards.

Mr Y (PO-27828) – scheme booklet did not constitute a contract between the member and the trustee in relation to GMP increases

Summary

The Pensions Ombudsman has partly upheld a member's complaint in relation to a change to the pension increase rule for the GMP element of his pension. The Pensions Ombudsman held that the rule change had been validly introduced and that the scheme booklet did not constitute a contract between the member and the trustee. However, the trustee was directed to pay the member £500 for the significant distress and inconvenience caused by providing the member with incorrect information.

Background

Mr Y joined the Gifford Retirement Benefits Scheme (Scheme) in April 1992. At that time, he received a booklet which stated that his GMP would be increased by 3 per cent per year. The booklet stated that *"in the event of any discrepancy between this booklet and the Trust Deed and Rules, the latter will prevail."*

In 2004, the Scheme rules were amended to provide that, from that date, GMP increases would be in line with statutory requirements.

When Mr Y claimed his pension in 2021, he was told that the GMP element of his pension was increased by 3 per cent. The error was discovered in 2018 and the scheme administrator notified the member that he had been overpaid to date by £318.18. The trustee proposed to freeze Mr Y's pension at the current level until the overpayment was recovered. However, because the value of Mr Y's increase that year was more than the value of the overpayment, Mr Y would still receive a slight increase that year.

Mr Y complained and the trustee offered to repay the overpayment of £318.18 but said that future increases needed to be in line with the Scheme rules. Mr Y complained to the Pensions Ombudsman.

Complaint to the Pensions Ombudsman

Mr Y argued that the documentation provided to him at the time he joined the Scheme stated that his GMP would increase by 3 per cent per year. The Scheme was closed to future accrual which meant that the change should have been notified to him. Mr Y also argued that the change contravened Section 67 of the Pensions Act 1995.

The complaint was considered by an Adjudicator who found that the change had been introduced validly in accordance with the requirements of the Scheme's power of amendment. The change did not have any retrospective negative impact on the GMP, as the increases were only changed from 2004. Although the change to the Scheme rules was valid, they had been incorrectly applied and Mr Y had therefore received an overpayment, which the trustee had agreed to waive. However, Mr Y was only entitled to GMP increases from 2004 in line with the statutory requirements.

Pensions Ombudsman's determination

Mr Y did not accept the Adjudicator's opinion, arguing among other points, that the 1992 Scheme booklet constituted a contract between him and the trustee. The Pensions Ombudsman did not accept this argument, noting that the requirements for contract formation had not been met and that the Scheme's rules took priority over the Scheme booklet. The Pensions Ombudsman therefore did not uphold Mr Y's complaint in relation to the change to the GMP increase rule.

However, the Pensions Ombudsman directed the trustee to pay Mr Y £500 for the significant distress and inconvenience caused by the provision of incorrect information (effectively increasing the trustee's offer to waive the overpayment to £500).

The full determination can be viewed here.

Comment

The Ombudsman's decision is not surprising, given that it is well established that scheme booklets do not override the scheme's governing documentation (particularly in this case where the scheme booklet included disclaimer wording). However, trustees should be aware that where they provide incorrect information, the Pensions Ombudsman may make a finding of maladministration and make an award to the member for distress and inconvenience.

Mr S (PO-26272): application of waiver of early retirement reduction where member had different tiers of benefits

Summary

The Pensions Ombudsman did not uphold a member's complaint that he was entitled to take all his benefits under the scheme unreduced from age 60. However, the Pensions Ombudsman directed the trustee to pay Mr S £1000 for the serious distress and inconvenience caused by the provision of incorrect information.

Background

Mr S joined the lower tier of the Novar Executive Pension Scheme (Scheme) in April 1991 and the middle tier in March 1998. He left the Scheme in 2003 and became a deferred member. There are different retirement dates for the lower and middle tiers of the Scheme: ages 65 and 62.5 respectively.

Under a 2003 agreement signed by the employer, it agreed *"that the early retirement factor relating to two and a half years before NPA be waived"* in respect of Mr S. In a subsequent letter to Mr S, he was told that *"The Company has exercised discretion to waive 2.5 years of any reduction to the pension payable to you from the Executive Scheme. This means that you could retire from the age of 60 (rather than 62.5) without an early retirement reduction being applied to the pension."*

However, another letter from the scheme administrator in 2003 erroneously informed Mr S that arrangements had been made so that he had the right to retire at age 57.5 without an early retirement reduction.

In June 2016, Mr S asked the new scheme administrator whether he could retire early at age 57.5 without a reduction. The administrator initially stated that Mr S had a 2.5-year early retirement waiver, so that he could retire at age 60 in respect of his lower tier benefits and at age 57.5 in respect of his middle tier benefits without a reduction. The administrator subsequently corrected its position, stating that Mr S could retire at age 62.5 in respect of his lower tier benefits and at age 60 in respect of his middle tier benefits without a reduction.

Mr S argued that he was entitled to retire early at age 60 without a reduction in respect of all of his benefits, as set out in the 2003 letter. The trustee did not uphold his complaint but offered to pay him £500 in compensation (this was subsequently increased to £750 during the complaint to the Pensions Ombudsman, although Mr S did not accept this offer).

Mr S complained to the Pensions Ombudsman.

Pensions Ombudsman's determination

The Pensions Ombudsman agreed with the decision by the Adjudicator and did not uphold Mr S's complaint in relation to the early retirement reduction waiver. The 2003 letter to Mr S stated that the employer had exercised its discretion to waive 2.5 years of any reduction to the pension payable to Mr S from the Scheme and that Mr S should reasonably have understood this statement to mean that the 2.5 years waiver would be applied to the retirement ages applicable to each tier of benefits (i.e. the second sentence only applied to his middle tier benefits).

However, it was undisputed that the current and previous administrators had provided Mr S with incorrect information and that these mistakes had caused Mr S serious distress and inconvenience. The Pensions Ombudsman directed the trustee to increase its offer to Mr S to £1000 to remedy this injustice.

Comment

This decision highlights the importance of ensuring that communications with members about their pension benefits are clear and accurately reflect any decisions which have been taken by the employer or the trustee. In the case of the 2003 letter, what may have been intended as an helpful explanatory statement (that the early retirement waiver meant Mr S could retire at age 60 without reduction) caused confusion as it did not expressly refer to the different tiers of benefits to which Mr S was entitled under the Scheme.

The full determination can be viewed here.

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 Pension Regulator's powers, and the revised Funding Regime. The Bill had its second reading in the House of Commons on October 7, 2020. It will now enter the committee stage which is expected to be completed by November 5, 2020.

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

December 16, 2020 – Closing date for comments on the Pensions Regulator's provisional corporate strategy.

January 6, 2021 – Deadline for submitting compliance statement in relation to objective setting for investment consultants under the CMA Order.

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. For "relevant schemes" (broadly, money purchase schemes with 100 or more members), the requirement to publish an implementation statement online applies as soon as the accounts have been signed after 1 October 2020 (but in any event no later than 1 October 2021).

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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