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What's Happening in Pensions

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DB scheme funding and Pensions Regulator powers

The government **has published** its response to its June 2018 consultation on strengthening the powers of the Pensions Regulator and associated proposals (see **WHiP Issue 71**), and the Pensions Regulator has issued its **2019 annual funding statement**.

In summary:

- The government is pressing ahead with most of its proposals to strengthen the Regulator's powers and to introduce new notification requirements for pension scheme trustees, sponsoring employers and related parties. It is clear that there will be significant changes in relation to scheme governance and funding, and new measures in relation to corporate activity and other events that might detrimentally affect pension schemes. Changes include new criminal offences and significant financial penalties. However, no timescale for these new powers and requirements is given and much of the important detail is yet to be settled.

- The Pensions Regulator's 2019 annual funding statement includes strong messages about long-term funding targets and investment strategies, recovery plan lengths, and the equitable treatment of pension schemes in deficit when considering shareholder distributions such as dividends.

See our briefing note **Confirmed government plans for the protection of DB pensions** for more detail.

Brexit

The Pensions Regulator has issued a short **statement about Brexit**, aimed primarily at trustees of DB schemes. It reminds them of its 2016 statement (see **WHiP Issue 59**) and says:

- Where relevant, trustees should undertake a review of any actions or contingency plans in the context of a possible "no deal" Brexit, if they have not already done so.

- Trustees should note the government's guidance in respect of the payment of occupational pension scheme benefits to **EU citizens in the UK** and **UK nationals in the EU** in a "no deal" scenario. They should speak to their administrator and be prepared to communicate to members, while ensuring continuity of payment of benefits.

- Schemes currently authorised and approved to accept cross-border contributions, and those who are considering applying for authorisation and approval, will need to consider the implications of the UK’s withdrawal from the EU and how either a withdrawal agreement or "no deal" might affect them and their members. Trustees of schemes that are currently authorised and approved as a cross-border scheme should also be considering contingency plans in a "no deal" scenario, together with participating employers and their scheme advisers. Trustees who may be considering applying for authorisation to commence cross-border activity should, where possible, wait until there is more certainty before commencing any application.

Investment consultancy and fiduciary management

CMA report

The Competition and Markets Authority (CMA) has published a **draft order** and **explanatory note** to implement the previously announced remedial action affecting fiduciary management service providers and investment consultants, and pension scheme trustees who engage or already use their services (see **WHiP Issue 74**). The order will be in place by the statutory deadline of 11 June 2019 and comes into force six months after it is made.

- **Fiduciary management:** In broad terms, the CMA order will require pension scheme trustees who wish to delegate investment decisions for more than 20% of their scheme assets to a fiduciary manager to run a competitive tender with at least three firms. Trustees who have appointed a fiduciary manager without a tender must put the service out to tender within five years.

- **Investment consultancy:** The CMA order will require trustees to set strategic objectives for their investment consultants, which will be closely linked to the scheme's investment objectives in most cases. This will apply both when engaging new consultants and for existing appointments.

Trustees will have to submit annual compliance statements in respect of both of the matters outlined above. The first are due for submission within 12 months and one week from the date the order is made. The CMA will have the power to demand information for the purposes of monitoring compliance.

There are also (among other things) provisions on the information that investment consultants and fiduciary management service providers will have to give to trustees.

Government and Pensions Regulator response

The government and Pensions Regulator **responded** to the CMA, agreeing with its proposals and outlining their decisions on matters within their ambit as follows:

- The DWP will put forward legislation to enable the Pensions Regulator to oversee the duties on trustees outlined above. It will, later this year, consult on draft regulations putting the CMA's remedies, insofar as they apply to trustees, into pensions law. Subject to Parliamentary time, the regulations would come into force, replacing the CMA order, in 2020.

- The Regulator will produce guidance to help trustees to comply with their new obligations, which will also cover trustees' overall engagement with their investment consultants and fiduciary management service providers. It expects to consult on a draft this summer.

- In the context of competing priorities for the government and financial services sector, HM Treasury will consider the recommendation that it extend the FCA's regulatory perimeter to cover services provided by investment consultants and will consult in due course.

FCA response

For its part, the FCA **responded** to the CMA as follows (these matters do not directly affect trustees):

- Once certain CMA remedies are in place, the FCA will consult on new rules for firms offering fiduciary management services. These relate to matters including firms offering both fiduciary management and investment consultancy services being required to separate the marketing of fiduciary management services from the provision of investment consultancy advice, fiduciary management providers being required to disaggregate fees for current customers, and firms offering fiduciary management services providing more information about their fees to prospective customers, including transition and exit costs, asset management fees and custodian fees.

- The FCA will work with HM Treasury and the CMA to take forward the extension of its regulatory perimeter to capture the full scope of investment consultancy services, including asset allocation advice. Among other things, this would allow the FCA to consult on rules to incorporate the CMA's remedies into its regulation.

- The FCA will continue to maintain its oversight of transparency of asset management fee reporting. It will also continue to engage with the cost transparency initiative in its status as an observer. It will reconsider disclosure to institutional investors if it considers the market is not operating effectively.

EMIR clearing exemption

The government **has announced** what it will do to ensure that a pending EU extension of the EMIR derivatives clearing exemption for pension schemes will apply in the UK after a "no deal" Brexit.

The existing exemption for pension schemes expired in August 2018 but has for some time been in the process of being extended, via a new EU EMIR Refit Regulation. If the Refit Regulation becomes EU law before Brexit then the European Union (Withdrawal) Act 2018 will automatically make the amended EU law part of UK law from Brexit day. In case the Refit Regulation does not become EU law until after Brexit (from which point future EU laws will not apply in the UK), a new UK government Bill will enable the UK to adopt the changes.

The FCA later published a **joint statement** by the UK and US authorities on continuity of derivatives trading and clearing post-Brexit.

Stewardship

New stewardship code

The FRC **has consulted** on a new Stewardship Code for institutional investors (including pension schemes) in relation to UK listed companies. The draft 2019 Code includes substantially higher expectations.

The main proposed changes to the Code include:

- Investors must report how their purpose, values and culture enable them to meet their obligations to clients and beneficiaries. This aligns the Code with the UK Corporate Governance Code and encourages embedding behaviour conducive to effective stewardship in the investor community.

- The proposed Code now refers to environmental, social and governance (ESG) factors. Signatories are expected to take material ESG issues into account when fulfilling their stewardship responsibilities.

- The proposed Code now expects investors to exercise stewardship across a wider range of assets (more than just listed equity) where they have influence and rights, in the UK and globally.

The draft Code sets out more rigorous requirements for reporting, focusing on how stewardship activities deliver outcomes against objectives. Reporting will be subject to increased oversight by the FRC to ensure the Code is effective in raising the quality of stewardship.

In preparing the consultation the FRC engaged with 170 members of the investment community and companies, including the largest UK asset managers, pension funds, key international investors and UK listed companies.

The Code is expected to come into effect on 16 July 2019.

FRC/FCA discussion paper

A joint FRC/FCA **discussion paper** calls for input on how best to encourage the institutional investment community to engage more actively in stewardship of the assets in which they invest. Comments are to be submitted by 30 April 2019.

FCA consultation

There has also been an **FCA consultation** on proposals to improve shareholder engagement for regulated financial services firms.

Collective DC schemes

The government **has responded** to its consultation (see **WHiP Issue 73**) on allowing collective defined contribution (CDC) occupational pension schemes to operate as money purchase schemes. It has confirmed that it will be going ahead with the proposals with only one alteration of any significance.

The forthcoming legislation will facilitate the CDC model agreed by Royal Mail and the Communication Workers Union. Under this model, target defined benefits are communicated but not promised. Investments are pooled (not selected by members) and pensions are paid from the scheme. Adjustments are made to pensions in payment and to benefit targets based on the funding position from time to time.

Primary and secondary legislation is needed in order to allow this type of scheme to operate without it being subject to the legislation applicable to non-money purchase schemes, including in relation to scheme funding. CDC schemes will be subject to the laws applicable to money purchase schemes but a number of these requirements are not consistent with how this CDC model works and will be disapplied or amended - for example: statutory money purchase illustrations, preservation rules, disclosure requirements about retirement options, and the pensions advice allowance. Due to the potential for members to misunderstand how a CDC scheme works, there will be additional disclosure of information and risk warning requirements.

HMRC will need to decide, among other things, how the annual allowance and lifetime allowance will work for CDC schemes: a consultation is expected. CDC scheme members will be able to access the "freedom and choice" decumulation options but apparently only by transferring out to another scheme.

The legislation will require CDC schemes to have annual valuations, which will have to be published along with other key scheme documentation. A best estimate funding approach will be required, with no compulsory funding buffer. The proposal that actuarial assumptions would need to be peer-reviewed by an independent actuary has been dropped. Adjustments to benefits should be made in the same way to active, deferred and pensioner members, in accordance with a formula set out in the scheme rules. CDC schemes will not be eligible for the PPF. Transfers out will be on a share of fund basis.

The 0.75% DC default arrangement charge cap will apply, on an aggregate basis across all of a CDC scheme's investments.

The Pensions Regulator will authorise (or otherwise) a scheme based on factors including its actuarial assumptions, underlying investment strategy, financial sustainability without ongoing employer contributions, whether the trustees are fit and proper, communications, systems and processes, and continuity strategy. The government is in discussions with the Regulator about these matters and a consultation is expected.

The government will draft the primary legislation to allow it to legislate by regulations for other CDC models but work on this will only begin after the Royal Mail scheme has been established. In due course, CDC commercial master trusts, industry-wide schemes and decumulation-only vehicles are expected to be able to operate.

There is no draft legislation yet and the only indication of timing is "as soon as Parliamentary time allows".

Long-term DC investment

The government **has published** "Investment Innovation and Future Consolidation: A Consultation on the Consideration of Illiquid Assets and the Development of Scale in Occupational Defined Contribution Schemes". Larger DC schemes would have a new reporting duty and smaller schemes would need to consider consolidation.

The consultation follows on from the government's Patient Capital Review. It sets out proposals to encourage DC occupational pension schemes to consider investing more widely in illiquid long-term investments. That would include (among other things) investments in infrastructure projects and private equity.

The proposals include:

- requiring large DC schemes to report their policy and practice regarding these types of investment;
- requiring smaller DC schemes to assess, every three years, whether they should consolidate into a larger scheme; and
- adding a new option for measuring charges against the automatic enrolment DC scheme default arrangement charge cap, to accommodate the performance fees that are often a feature of this kind of investment.

Professional trustee standards

The Association of Professional Pension Trustees (APPT) **has announced** the publication by its Professional Trustee Standards Working Group of new **standards** for professional trustees of occupational pension schemes.

The standards will apply on an individual basis to anyone who meets the definition of a professional trustee in the Pensions Regulator's August 2017 "**Professional trustee description policy**" (see **WHiP Issue 66**). There are additional standards for professional trustees who chair a trustee board or are the sole trustee. The finalised plans replace the original proposal for a "comply or explain" regime.

To be accepted as an "Accredited Professional Pension Trustee", applicants will have to:

- satisfy a "fit and proper" requirement modelled closely on that required for trustees of master trusts;
- provide references from two reputable figures within the industry, such as an existing accredited professional trustee, a pensions lawyer or a scheme actuary;

- have successfully completed the latest Pensions Regulator Trustee Toolkit;
- have passed the PMI's Level 3 Award in Pension Trusteeship; and
- complete an online soft skills test designed to assess the "other Professional Trustee skills and behaviours" associated with professional trusteeship (which is yet to be developed).

The originally proposed requirement for the trustee to have professional indemnity insurance has been dropped.

To maintain status as an Accredited Professional Pension Trustee, individuals will have to:

- complete an annual attestation confirming that they remain "fit and proper", that they continue to adhere to the standards and that they have completed any new or updated modules in the Trustee Toolkit; and
- complete 25 hours' relevant continuous professional development (CPD), at least 15 hours of which must be structured CPD (ie, a formal event such as a conference, seminar or trustee training session).

The Pensions Management Institute will manage the accreditation framework, which is expected to commence by mid-2019. It will be overseen and maintained by the APPT council. Fees will be payable but the amounts are yet to be set.

A **response** to the December 2017 consultation (see **WHiP Issue 69**) has also been published.

There is nothing in the published documents about the consequences for a scheme of a professional trustee being unaccredited but we expect the Pensions Regulator to apply greater scrutiny to the governance of a scheme where the scheme return reveals that there is an unaccredited professional trustee.

Transfer exercises

The Pensions Regulator, FCA and TPAS have issued a **joint protocol**, designed to enable early intervention to help ensure that members are fully informed when considering a transfer offer from a DB scheme.

As well as describing how the parties will share information and collaborate in other ways, the protocol includes template letters to be adapted in specific cases, which any of the three parties can initiate. They will always be issued when the Pensions Regulator agrees a pension scheme restructuring. In such cases, TPAS (now part of the Single Financial Guidance Body, which is to be renamed the "Money and Pensions Service") will consider whether a dedicated hotline is appropriate and the FCA will consider targeted action in specific geographical regions.

The template letters are:

- a covering letter to the trustees reminding them of their obligations, setting out what the member letters are for, when they should be sent to members, how to contact each of the organisations and the information they should collate and send to the FCA; and
- a member letter setting out important information on points the members should consider before making a decision and where they should go for impartial guidance. This letter should be sent by the pension scheme administrators when a member asks for a cash equivalent transfer value quotation or, where relevant, to all members or a specific cohort of members.

The Regulator says that 31 schemes have already been asked to issue such member letters.

This initiative coincides with the publication of the **Caroline Rookes report** on the communications and support provided to British Steel Pension Scheme members during the recent restructuring. The report was commissioned by the Pensions Regulator in response to a Work and Pensions Select Committee recommendation. It said that the Pensions Regulator, FCA and what will be the Money and Pensions Service should work more collaboratively and provide guidance to trustees and members in situations where members are given choices including a transfer.

Scheme data

The Pensions Regulator has published a **quick guide** for pension scheme trustees on measuring scheme data. The guide outlines the data trustees need to measure, how to do it, and how to calculate data scores.

The data score is the percentage of members in the scheme that trustees assess to have fully present and accurate data. Separate scores are to be calculated for "common data" and "scheme-specific (conditional) data". The guide explains what data items these terms include.

The Regulator expects trustees to review their data at least once a year, with an additional review if a significant event happens, such as a winding-up or a change of administrator or administration system. Trustees who identify issues are expected to put an improvement plan in place to resolve them.

The Regulator has also reissued its **quick guide to improving scheme data**.

PPF compensation

The PPF **has reported** that there is a legal challenge to its intended approach to the calculation of increases due to its members as a result of the European Court's ruling in the *Hampshire* case (requiring minimum 50% compensation – see **WHiP Issue 72**).

The detail given of the challenge is sparse. The PPF had intended to make a one-off adjustment and pay interest on arrears at the Bank of England's base rate. It will still proceed with the adjustment but will limit arrears payments pending the outcome of this challenge.

Age discrimination

The government **has said** that it is seeking permission to appeal the judges' and firefighters' age discrimination cases (see **WHiP Issue 74**) to the Supreme Court.

It estimates a potential cost to taxpayers of £4 billion a year if the Court of Appeal's judgment stands or is upheld, ie, if it has to grant to all public sector scheme active members the transitional benefits given to older public sector workers when public sector pensions were reformed.

The potential liability has led to the government putting on hold potential improvements to public sector benefits arising from (in the absence of this liability) bigger than expected savings from the reforms.

BT cases on pension increases

BT **has reported** that it is seeking permission to appeal both of the recent judgments against it in relation to pension increases. These were:

- the Court of Appeal decision that it could not switch from RPI to CPI for section C of the BT Pension Scheme, within the language of the relevant provisions of the scheme rules (see **WHiP Issue 74**); and
- the High Court's judicial review ruling, concerning the government's decision that public sector schemes will pay top-up pension increases for members with GMPs who reach state pension age after 5 April 2016 (and so miss out on payments from SERPS), which has a knock-on effect for the BT Pension Scheme (see **WHiP Issue 74**).

VAT – DC schemes

A government **Order** puts onto a statutory footing HMRC's existing practice of complying with the European Court's decision in the 2014 *ATP* case (see **WHiP Issue 45**), regarding VAT on fees for DC pension management and administration services.

After the decision of the European Court in that case, HMRC accepted that DC pension schemes, or funds within them, that have certain characteristics (which are common to such arrangements) fall within the definition of "special investment funds" for the purposes of the EU VAT Directive fund management exemption. This has the effect that the services of managing and administering the DC funds are exempt from VAT.

The changes are to come into force on the day on which the UK leaves the EU. They are, however, needed in order to make UK law (rather than just HMRC practice) reflect EU law even while the UK remains within the EU.

Winding-up DC schemes

The Pensions Regulator has published new **guidance** on winding up a DC scheme.

It covers matters such as:

- deciding whether the scheme should be wound up;
- preparing for and triggering the winding-up;
- securing members' benefits; and
- final steps to complete the winding-up.

Pension protection levy

The PPF will replace Experian with Dun & Bradstreet (D&B) for pension protection levy insolvency risk purposes from the 2021/22 levy year.

D&B will build a replica of the existing insolvency score model and an online portal for levy payers, which suggests that the PPF is looking to minimise the impact of the changes. D&B was the provider of these services previously, until the 2015/16 levy year.

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If you wish to discuss any points arising from this note, please speak to your usual contact in the Travers Smith Pensions team or to one of the Pensions partners: Susie Daykin, Daniel Gerring, David James, Dan Naylor and Paul Stannard.

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