NORTON ROSE FULBRIGHT

Essential UK Pensions News

August 2021

Introduction

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

A stronger Pensions Regulator

Pensions Regulator to prosecute over employer-related investment

The Pensions Regulator has announced that it will prosecute a former owner of Norton Motorcycles for investing into the business money from three defined contribution pension schemes of which he was the sole trustee.

He is accused of investing more than five per cent of assets from each scheme into his business. To do so would amount to a criminal offence under restrictions on "employer-related investment".

Overseas parent agrees financial support for Keytec scheme

The Pensions Regulator has published a regulatory intervention report confirming that it has overseen the negotiation of a financial support package for a defined benefit pension scheme with the employer's German parent company.

The scheme in question was a small hybrid scheme belonging to UK-based distribution company, Keytec (GB) Limited. It had been on the Regulator's radar since the 2016 valuation.

The Regulator was concerned because:

- It considered the scheme was being treated unfairly in comparison with shareholders. Only £30,000 was paid by way of deficit repair contributions in the year ending April 2016. By contrast the employer paid a dividend of nearly £900,000 following the winding up of its manufacturing business in 2015.
- The employer had become a service company over time and seemed likely to need parent company help to support the scheme.
- Existing guarantees provided by the German parent company, Turbon AG, were limited in value and duration.

The Regulator issued a warning notice for a financial support direction (FSD) against the German parent company. No FSD was issued. Following negotiations involving "extensive" Regulator engagement, the parent company agreed a package of support with the trustee including:

- An agreed self-sufficiency target resulting in a £1.8m deficit figure.
- An upfront lump sum contribution of £636,000.
- Improved guarantees to underwrite the employer's ongoing funding obligations and any "section 75 debt".
- An agreed funding framework for future valuations.
- A recovery plan end date of December 31, 2030.

Comment

In recent years the Pensions Regulator has repeatedly stressed the importance of treating a pension scheme fairly relative to other stakeholders. That, alongside concerns about covenant strength, appears to have been a major reason for the Regulator's interest in this case. This case is also another example of the Regulator being willing to use its powers against overseas parent companies.

Governance

Pensions Regulator publishes interim response to Single Code consultation

The Pensions Regulator has published an interim response to its consultation on a single code of practice. It will publish a full response once it has fully considered the feedback it has received.

Key issues include:

Issue raised	Response
Not always clear to what type of scheme each module applies.	The Regulator will revisit this.
Timescales for completing the "own risk assessment" (ORA) are too tight	The Regulator's response implies that schemes could choose to adhere to the longer time scales set out in the legislation and that the Regulator's recommended timescales are only "best practice" guides. The draft Code currently requires a first ORA within a year of the Code coming into force, whereas the legal deadline is (broadly) a full scheme year plus 12 months after the Code is in force. The Regulator will revisit how often trustees should review the ORA – the legal minimum is every three years rather than the annual review required by the draft Code.
Capping unregulated investments at 20 per cent is problematic	The Regulator says its intention was *"to protect members of poorly run, and typically small, schemes from investments in poor quality or inappropriate assets".* It had not intended to catch *"well governed, typically larger, schemes that hold unregulated assets as part of a well-managed investment strategy".* It will not proceed with this expectation *"in the way it is drafted".* However, it does intend to add something to the Code that will achieve its original policy objective *"whilst allowing schemes with liquidity risk management plans and prudent investment strategies to maintain exposures to unregulated assets".*

A cap on unregulated investments also seems at odds with the ambitions of the Prime Minister and Chancellor to increase pension scheme investment in long term assets (see below). Schemes for which the 20 per cent cap would have been problematic will welcome this news – provided the new wording in the next version of the Code does not also have unintended consequences.

On timing, the Regulator is not committing to a final publication date for the new Code. However, it has said that it does *"not expect to lay the new code in Parliament before spring 2022. It is, therefore, unlikely to become effective before summer 2022."*

PASA examines DC "statements season" proposal

The Pensions Administration Standards Association (PASA) has set up a working group to consider the potential issues associated with simplified annual benefit statements and the proposal to have a DC "statements season". One such issue may be an administrator "capacity crunch".

The PASA working group will relay its conclusions to the Department for Work and Pensions.

With a growing compliance burden for DC schemes building this autumn and next spring, we expect many administrators and DC schemes will be following these developments closely.

Transfers and scams

Regulators get tough to protect members

August saw a range of regulators taking action in relation to poor transfer advice and scams.

The Financial Conduct Authority (FCA) decided to fine a financial adviser nearly £1.3m and ban him from advising on pension transfers. This was for "seriously incompetent" advice to over 400 customers (including nearly 200 members of the British Steel Pension Scheme) on the transfer of their defined benefit pensions into alternative arrangements.

We may hear of more such cases in due course. The FCA, Financial Ombudsman Service and Financial Services Compensation Scheme plan to meet steelworkers in Port Talbot in September to make them aware of their right to complain about unsuitable pension transfer advice.

Two solicitors have been struck off the solicitors' roll in a case brought by the Solicitors Regulation Authority (SRA). This is reportedly for giving dishonest and incompetent legal advice on investing in self-storage pods through a self-invested pension plan (SIPP).

The Information Commissioner's Office (ICO) has fined a company £50,000 for "cold calling", i.e. making unsolicited telephone calls to people about their pensions. This has been illegal since 2019 where no informed consent has first been obtained. In this case the company had improperly relied on general and unspecific consents to direct marketing given by the individuals to other websites.

Meanwhile the Work and Pensions Committee continues to put pressure on the Government to strengthen the Online Safety Bill so that online platforms are obliged to prevent fraudulent paid-for advertisements about pensions.

Investment

PM and Chancellor issue "call to action" to invest in British assets

Prime Minister Boris Johnson and Chancellor Rishi Sunak have published a joint letter urging the UK pensions industry to invest in long term UK assets (e.g. infrastructure).

Johnson and Sunak want an "investment big bang" to promote Britain's recovery and support their levelling-up agenda. The letter highlights the steps the Government is taking to remove barriers to long-term investment, including reforming the charge cap to allow smoothing of performance fees and launching a new Long Term Asset Fund. Johnson and Sunak say they are willing to remove further barriers if needed.

The pensions industry has broadly welcomed the Government's aim to encourage this type of investment, provided it continues to recognise that investing in long-term assets may not be suitable for all schemes. Some schemes will still face obstacles such as liquidity needs, the charge cap (even with smoothing of fees) and challenges associated with costs and charges disclosure.

Pensions Regulator emphasises importance of good stewardship to tackle climate change

The Pensions Regulator has published a blog to explain to trustees what they can do to address climate change and influence the UK shift to net zero. It gives an interesting insight into the Regulator's view of what good looks like for stewardship and objective-setting.

The blog encourages trustees to apply pressure to their investment managers to really take climate change into account when building portfolios. This means doing more than simply saying *"do ESG stewardship for us"* as this would not challenge the investment manager's existing approach. Instead trustees should have a *"stewardship strategy"*, set clear goals for their investment managers and ultimately should *"vote with their feet"* if they are not happy with their current manager's approach. The Regulator also encourages trustees to sign up to the 2020 Stewardship Code.

Trustees may wish to bear these comments in mind when next reviewing their stewardship policy or investment manager's objectives.

GMP rectification and equalisation

PASA issues GMP equalisation guidance on historical transfers

Last month PASA published new GMP equalisation guidance on conversion (see our July edition of Essential UK Pensions News). Now it has published further equalisation guidance, this time on past transfers out of a pension scheme.

This follows the most recent *Lloyds* decision on GMP equalisation (November 2020), in which the High Court decided that certain transfer payments made by DB schemes since May 17, 1990 should have been calculated on an equalised basis, so transferring schemes can be liable for top-up payments.

This guidance is again the work of a cross-industry working group. It aims to take a *"pragmatic approach"* to equalising historic transfer payments, *"noting the judge (...) recognised the administration costs involved could easily exceed any correction".*

Again, PASA guidance is not a substitute for the law, and the guidance strongly recommends taking legal advice on many of the proposed steps. However following industry-wide guidance such as this is likely to help in defending a complaint from members.

Trustees undertaking GMP equalisation exercises should carefully consider the recommendations in this guidance and update their project plans if necessary.

The guidance looks separately at the implications of the latest *Lloyds* judgment for:

- Transferring schemes which paid individual transfer values.
- Receiving schemes which received individual transfer values.
- Bulk transfers between schemes.

It considers points such as:

- How to calculate top-up payments, especially where there is a lack of data.
- Time limits and forfeiture rules.
- Communicating with former members.
- Run-off insurance and employer indemnities on a scheme winding up.
- Whether, as a receiving scheme, to accept a top-up payment and, if so, what to do with it (looking separately at DB and DC schemes).

Restructuring

Court of Appeal confirms PPF compensation cap is unlawful but approves PPF approach

The Court of Appeal decision in *Secretary of State for Work and Pensions v Hughes* has provided some clarity on the compensation payable by the Pension Protection Fund (PPF) on employer insolvency. This is the latest in a series of cases that have challenged the way in which compensation is payable by the PPF.

Background

If an occupational pension scheme enters the PPF on an employer insolvency, the Pensions Act 2004 provides, broadly, that members who have reached Normal Pension Age (NPA), will receive compensation equal to 100 per cent of their scheme pension; but members who have not reached NPA will receive 90 per cent of their scheme pension subject to a statutory compensation cap (the Compensation Cap). The PPF's approach to survivors' benefits is to pay 50 per cent of the compensation payable from the PPF at the date the member died, rather than 50 per cent of the survivors' benefit that would be payable under the scheme rules (which could be more, e.g. a 2/3rds pension).

In September 2018, the Court of Justice of the European Union ruled in *Hampshire v PPF* that EU law required PPF compensation to be at least 50 per cent of the members' accrued scheme benefits. In response, the PPF started applying a one-off "value test" to ensure this requirement is met. Broadly, this involved valuing the benefits that the member would have received under the original scheme

rules and comparing this with the value of their PPF benefits. If the PPF benefits were worth less than half of the original scheme benefits, the PPF would uplift the PPF benefits accordingly.

A challenge was brought by Mr Hughes and others, arguing that:

- Less generous PPF annual pension increases could mean that in later years a member might start to receive less than 50 per cent each year of the benefits they would have received under the original scheme.
- The one-off value test relied on actuarial assumptions about life expectancy that could prove to be wrong.

In June 2020, the High Court in *Hughes* held that:

- The Compensation Cap amounts to unlawful age discrimination and must be disapplied.
- A "one off" test (rather than an annual comparison) was acceptable. The PPF could pay more than 50 per cent in some years and less in others provided that, overall, the cumulative level of compensation did not fall below 50 per cent of the value of scheme benefits over the pensioner's lifetime.
- However, the PPF would need to ensure that the member did in fact receive at least 50 per cent overall – which would mean checking at a later date that the actuarial assumptions were correct.
- The PPF's approach to survivors' benefits was unlawful, as survivors should receive compensation equal to at least 50 per cent of the value of benefits payable under the original scheme.

The Secretary of State for Work and Pensions and the PPF appealed the ruling.

Court of Appeal judgment

The Court of Appeal:

- Upheld the High Court's decision that the compensation cap constitutes unlawful age discrimination and must be disapplied.
- Supported the PPF's approach to increasing compensation payments and its approach to the payment of survivors' benefits. The PPF was entitled to rely on actuarial assumptions and did not need to perform a later check.

The judgment also puts a little colour on the size of the issue – no more than 0.5 per cent of PPF members are affected by the cap and the cost of removing the cap for the future for those who were already in the PPF would be about £200m, which is just under 1 per cent of the PPF's liabilities.

Next steps

There's more to come on this, as the period of time over which the cap has to be disapplied is not yet clear (i.e. how far back corrections need to be made for those affected in the past). The Secretary of State for Work and Pensions has been granted more time to address the Court on this issue. However, she has confirmed that she will not appeal this latest decision that the cap is unlawful.

The PPF has said that for now it will continue to pay members their current level of benefits and will provide more information on the implementation of the judgment as soon as it is able to so.

Industry trends

Pensions Ombudsman annual report reveals cases backlog

The Pensions Ombudsman's annual report and accounts show that 29 per cent of cases being investigated by the Ombudsman in 2020/21 took longer than 12 months to resolve (measured from when the Ombudsman received a valid application). This compares with 7 per cent of cases in 2019/20.

The report attributes this rise partly to the impact of Covid-19 and the increasing complexity of pension complaints. Demand for the Ombudsman's services has apparently remained steady compared to recent years but, according to its corporate plan for 2020-2023, the Ombudsman's office expects an increase in demand, including more cases related to furlough and scams. It says that *"tackling the backlog of older cases and improving customer waiting times is a priority".*

Schemes facing a member complaint to the Ombudsman may find they have to wait longer than expected for a resolution.

Overpayments – Pensions Ombudsman takes a member-friendly approach

The Pensions Ombudsman has recently published a member-friendly decision in an overpayments case. The case may make it easier for members with limited pensions knowledge to resist repayments.

Background

The subject of recouping overpayments has featured in several recent Pensions Ombudsman cases and the Ombudsman has confirmed that:

- The starting point is that money paid in error can be recovered, even if the pension scheme has been careless.
- However, the member may have a legal defence to repayment, including a "change of position" defence.

A critical element of a successful "change of position" defence is that the member received the overpayment "in good faith". This would not be satisfied where the member suspected that a payment had been made in error and failed to make reasonable enquiries.

In past decisions the Ombudsman has rejected the member's "change of position" defence where he considered the member ought to have spotted the error.

Mrs E's case

In Mrs E's case, the Ombudsman has clarified that the good faith test *"is a subjective one"*. Although it would have been possible to identify an error from the documents provided to Mrs E, the Ombudsman accepted that she had not properly read them and her understanding of pensions was *"very basic at best".*

He therefore considered that she had in fact not spotted the error and had acted in good faith.

He went on to find that she had a successful *"change of position"* defence in relation to more than half of the overpayment since she had spent that amount irreversibly. Her pension scheme has been ordered to reduce the amount of the overpayment it is seeking to recover in addition to a £1,000 award for serious distress and inconvenience.

Comment

Schemes that have made overpayments should not assume that the Ombudsman will find in their favour if the error was identifiable from the information provided to the member. This case suggests that the Ombudsman will take the member's level of pensions understanding into account in deciding whether they should have spotted the error.

Development	Expected timing	Suggested action*
Climate change risk governance and disclosure requirements start to apply	October 1, 2021, for first wave of schemes (assets of £5bn and above and all master trusts) October 1, 2022, for second wave of schemes (assets of £1bn and above) Requirements may be extended to smaller schemes (assets under £1bn) from late 2024 or early 2025 – TBC	Final regulations now available (subject to parliamentary approval). Develop project plan for implementing governance structures and reporting. Smaller schemes to consider whether to comply on a voluntary basis. Consultation on TPR's draft guidance running from July 5, 2021, to August 31, 2021
Requirement for trustees to publish an implementation statement online	For DB schemes: October 1, 2021 For DC and hybrid schemes (100+ members): As soon as accounts have been signed after October 1, 2020 (and no later than October 1, 2021)	Liaise with investment consultants and managers to gather relevant information to begin preparation of implementation statement and plan website publication.
New stronger powers for the Pensions Regulator (under the Pension Schemes Act 2021), including new criminal offences, come into force	October 1, 2021	Employers and trustees to carefully consider pension scheme ramifications of any corporate activity from point of view of new powers. Carefully document decisions. Review governance structures and policies/protocols to minimise risk of breaches.
Requirement for trustees of smaller DC schemes (assets of less than £100m) annually to assess the value provided to their members and, where they conclude value not provided, to consider winding up	October 1, 2021 (for scheme years ending after 31 December 2021)	Trustees to consider whether their DC scheme is in scope for the new requirements (final regulations now available, subject to parliamentary approval). Prepare for value assessment (if relevant) and for reporting in chair's statement and scheme return to the Pensions Regulator. If value assessment unlikely to be met, consider options for DC members.
Trustees of all DC schemes to report on net investment returns in the chair's statement	October 1, 2021 (for scheme years ending after October 1, 2021)	Gather relevant information and prepare for reporting (final regulations now available, subject to parliamentary approval).
DC charge cap amendments to allow smoothing of performance fees	October 1, 2021	Discuss with investment advisers.
Introduction of Long Term Asset Fund	Autumn 2021?	Discuss with investment advisers.
Statutory transfers: additional requirements	Autumn 2021	Review processes and assess trustee legal risk, in the light of the draft regulations, published for consultation May 14, 2021.

Compliance report for Competition and Markets Authority (CMA) regarding objective-setting for investment consultants and tendering of fiduciary manager appointments	January 7, 2022	Prepare the necessary documentation in good time and ensure it is submitted to the CMA before the deadline. In future, compliance may need to be confirmed to the Pensions Regulator, instead of to the CMA, through the annual scheme return. However, the regulations required to make this change have been delayed, probably to the first half of 2022.
New simpler annual benefit statements for DC schemes used for auto-enrolment	April 6, 2022	Keep watch for final rules and prepare new form of statement in time for April 2022 (if applicable). Consultation running from May 17 to June 29, 2021.
Reporting non-taxable pension death payments to HMRC using Real Time Information	April 6, 2022	Check scheme administrators are aware of and prepared for this new requirement.
Ensure members of occupational pension schemes aged 50+ have taken or opted out of guidance before they flexibly access or transfer DC benefits.	April 6, 2022? Consultation published July 2021 and closes on September 3, 2021.	Look out for final regulations and liaise with administrators to update transfer processes and prepare the necessary communications. Similar obligations will apply to personal pension schemes.
Introduction of the £100 "de minimis" threshold, below which flat fees cannot be charged for DC auto-enrolment schemes	April 2022?	This is still TBC.
Notifiable events: changes to current regime	Spring 2022? Consultation on detailed regulations expected "later in 2021".	Update or implement a notifiable events protocol for employers and trustee to minimise risk of breaches
Regulator's new single Code of Practice comes into force, including a requirement for an annual "own risk assessment"	Summer 2022? Interim response to consultation published August 24, 2021	Check scheme and employer are compliant with the Code's requirements. Consider planning first "own risk assessment", if relevant.
Climate change risk governance and disclosure requirements start to apply for: • asset managers, life insurers, FCA-regulated pension schemes • standard listed companies	2022 Consultations published June 22, 2021; final rules expected Q4 2021.	For noting only. Information from asset managers and investee companies may become more readily available which would help trustees with their own disclosures.
DB scheme funding: changes to requirements	Late 2022/2023	Consider scheme's long term objective and journey plan and discuss with employers. Look out for second consultation, expected late 2021, and consider implications with advisers.

Legislative framework for superfunds	2022/23	Look out for draft regulations and a consultation in due course. DWP expects to share its vision for a regulatory regime in autumn/winter 2021.
Statutory framework for Collective DC schemes	2022? 2023? Consultation launched on July 19, 2021, closing on August 31, 2021.	Target timing for regulations to come into force TBC.
Pension Dashboards	From April 2023 Compulsory staged on-boarding of schemes, starting with the largest schemes with 1,000+ members.	Look out for consultation, and draft regulations expected late 2021. Develop action plan for getting data ready for dashboard.
Rise in normal minimum pension age from 55 to 57	April 6, 2028	Draft legislation published July 20, 2021. Take advice on which members benefit from the new protected pension age (of 55). Update member communications.
RPI reform and switch to CPIH	2030	Take advice on implications for DB schemes and necessary actions.

*** This table sets out some indicative action points that trustees and employers may wish to consider but should not be read as a comprehensive plan of action or client-specific advice. Should you wish to discuss these issues further, please contact the Norton Rose Fulbright LLP pension team who will be happy to assist.**

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