Pensions Bulletin

June 2020

Welcome to the June 2020 Pensions Bulletin from Slaughter and May. In this month's Edition, we analyse the Pensions Regulator's guidance on reporting requirements following the ending of its COVID-19 easements. We also look at its guidance on DB superfunds. We cover the PLSA's drafting template for a DC Chair's Statement; compliance with trustees' obligations on fiduciary management services and investment consultants; the FCA's policy on the DB transfer market; and the pensions implications of the Corporate Insolvency and Governance Act. Finally, we report on a High Court ruling that the cap applied to certain compensation paid by the Pension Protection Fund is unlawful.

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I. COVID-19: TPR updates guidance on reporting requirements

TPR has updated its COVID-19 hub to reflect the ending, on 30 June 2020, of the easements on reporting breaches. From 1 July, pension scheme trustees are required to resume reporting information to TPR. As part of the updating, the DB scheme funding and investment advice for trustees has been rewritten. There are new sections on dealing with difficult decisions, the value of obtaining focused advice, and TPR's regulatory approach to suspending/reducing contributions.

COVID-19: an update on reporting duties and enforcement activity has been updated to reflect the ending on 30 June 2020 of the various reporting and enforcement easements. From 1 July, pension scheme trustees are required to resume reporting information to TPR including:

- suspended or reduced contributions – trustees will need to submit a revised recovery plan or a report of missed contributions, in line with legislation and the DB funding Code of Practice. For missed contributions, trustees will also be expected to inform members in line with the Code of Practice on reporting late payment of contributions;

- late valuations and recovery plans not agreed; and

- delays in CETV quotations and payments.

TPR says it will continue to regulate "*pragmatically and sympathetically*". Other areas covered in the updated guidance include:

- **Late payments to DC schemes:** TPR will continue to give DC and auto enrolment providers 150 days (instead of 90 days) to report late payments of contributions. TPR says that this extension will be reviewed at the end of September 2020, when the results of the 150-day reporting period will be seen.

- **Pension transfers:** Trustees should continue to issue a letter template to all members requesting a CETV quote and monitor requests for concerning patterns. Trustees who identify unusual or concerning patterns should contact the FCA on DBTransferSchemeInformation@fca.org.uk.

- **Annual benefits statements:** TPR says it is continuing to take a pragmatic approach to annual benefits statements, accepting that the impact of COVID-19 means schemes need additional time to issue them to members.

- **Accounts:** Trustees will be asked to report any failure to prepare audited accounts but TPR will not be looking to take enforcement action on late accounts signed off by 30 September 2020.

- **Chair's Statements:** The legislation on Chair's Statements does not allow TPR discretion to waive penalties - this applies to late issuance or inadequate content, as well as non-submission. The Statement must be included in the annual report and accounts, but can be prepared and signed off separately. For more on this, please see item III below. TPR says it does not expect to be reviewing statements before Autumn 2020.

TPR's updated COVID-19 DB scheme funding and investment guidance for trustees recasts the original (27 March 2020) version and consolidates other guidance. TPR says does not anticipate issuing any further updates unless circumstances change significantly. The updating covers the following:

- **Suspending or reducing contributions:** Employers are now likely to have financial projections reflecting the likely impact of COVID-19, enabling trustees to review in more detail the business case for a new or continuing suspension or reduction. These may remain appropriate, but TPR says it does not expect trustees "*unquestioningly*" to extend their original suspension arrangements on a three-month rolling basis. Trustees should consider whether it is in the members' best interests to agree to a suspension or reduction, even where the request is part of a larger coordinated request across other stakeholders that may appear equitable.

  The guidance sets out protections that trustees should seek, including:

  - the cessation of dividends or other forms of shareholder distribution until the deferred or suspended contributions are paid

   - the agreement of triggers for contributions to restart/increase contributions
   - agreeing legally enforceable protections to avoid the scheme being unfairly prejudiced against other stakeholders.

  Special considerations apply for schemes with employers where short term visibility remains "*extremely limited*" - any concessions should be considered alongside other financial creditors agreeing concessions.

- **Covenant monitoring:** The guidance includes a list of questions trustees should ask of the employer as part of their covenant monitoring and contingency planning, based on the list previously contained in the separate "distressed employer" guidance. If there is evidence that the employer covenant has materially worsened and is not expected to recover within a "*reasonably short*" timeframe, TPR says trustees should consider updating their funding arrangements (for example, calling a new actuarial valuation and/or revising the recovery plan). In that case, the relevant documents will need to be submitted to TPR in accordance with the funding legislation and Code of Practice.

- **Decision-making and advice:** TPR notes that trustees may need to seek independent advice beyond their normal advisers, for example in relation to understanding their scheme's position in refinancing, restructuring or insolvency scenarios. Where there are competing stakeholders, TPR recommends that trustees take advice (including legal advice) on their negotiation options. It says the costs of this advice may be recoverable out of scheme assets if permitted by the trust deed (which could be amended if not).

- **DB transfers:** TPR recognises that there may be a delay in payments due to a combination of increased demand, staff shortages and the possibility of trustees revisiting the basis on which CETVs are calculated. TPR confirms that trustees should report breaches of the transfer requirements from 1 July 2020 but says it will continue to take a "*pragmatic*" approach to breaches caused by COVID-19 issues. It points out that trustees may, having taken advice, consider taking advantage of the permitted additional period to issue transfer quotations "*for reasons outside their control*".

- **Ongoing valuations and recovery plans** that are not agreed: TPR cannot waive the 15-month deadline but will continue to take a "*reasonable*" approach to late submission.

Finally, TPR has updated its Automatic enrolment and DC pension contributions: COVID-19 guidance for employers to reflect Phase 2 of the Coronavirus Job Retention Scheme, in particular that

- the Scheme will close on 31 October 2020;
- from 1 July 2020, staff on furlough may work part of the time for their employer ("flexible furlough");
- for claims starting on or after 1 August 2020, employers will no longer be able to claim a grant for up to the statutory minimum automatic enrolment employer contribution.

II. DB consolidators: TPR issues interim regulatory guidance

Under pressure to keep pace with market developments, including burgeoning new capital investment models, TPR has updated its guidance on DB commercial consolidators ("superfunds"). Superfunds are set up to accept bulk transfers of assets and liabilities from other DB pension schemes, to provide an alternative way for a sponsor to separate itself from its DB liabilities. The guidance, which has immediate effect, sets out the standards TPR expects to be met by superfunds in the interim period before new legislation is in place. It also highlights issues for employers and trustees considering a transfer to a superfund.

TPR has published guidance on a framework for regulating DB superfunds. This follows the DWP's consultation last year (see our Pensions Bulletin January 2019). The guidance sets out the minimum standards superfunds must meet in the interim period before the DWP introduces new legislation. Superfunds will be expected to obtain confirmation from TPR that they meet these standards before accepting transfers from schemes.

The guidance requires trustees/directors running superfunds to submit information to TPR demonstrating:

- The superfund is financially sustainable and has adequate contingency plans to manage funding level triggers as well as to ensure an orderly exit from the market. TPR will require superfunds to hold sufficient assets to meet the promises to members with a high degree of certainty. This will include a requirement for liabilities to be calculated using specific assumptions and for additional assets to be held in a capital buffer, available to the trustees of the scheme in specified events. The superfund will have to be funded on a prudent basis.

- The superfund is run by fit and proper people, capable of being supervised by the trustees and has effective governance arrangements in place. The superfund must have sufficient administrative systems and processes to ensure that it is run effectively.

Employers making transfers to superfunds ("ceding employers") must apply for clearance – transferring to a superfund removes the employer covenant, and therefore is potentially a "Type-A" (materially detrimental) event. TPR expects to see evidence of the ceding trustees' due diligence. TPR will not issue any clearance statements for entry to a superfund before they have assessed the superfund against their criteria. Superfunds will need to provide prospective ceding employers and trustees with full details of their offering, fees (which must be justifiable), funding and investment objectives and methods for achieving those objectives.

The guidance confirms that there will be a "gateway" test, as proposed in the DWP consultation: a superfund should not accept a transfer from a ceding scheme that has the ability to buy-out or is on course to do so within the foreseeable future (for example, in the next five years).

TPR will be updating its equivalent guidance for trustees and for employers on transfer to a DB superfund. The current versions make it clear that TPR will need to be convinced that trustees consider a transfer to be the best option in the interests of beneficiaries (compared with maintaining the link with the employer or an insurance buy-out, for example). Independent covenant advice will be essential. TPR will also assess whether any detriment to the scheme has been adequately mitigated.

III. DC Chair's Statement: PLSA template

The Pensions and Lifetime Savings Association (PLSA) has produced a drafting template for a DC Chair's Statement (also known as the annual governance statement). The accompanying drafting notes pick up on areas where trustees can easily fall foul of the detailed legislative requirements.

The PLSA template for DC schemes obliged to draw up a Chair's Statement is based on the requirements of Regulation 23 of the Scheme Administration Regulations 1996 and TPR's Quick Guide on Chair's Statements. The essential point is that *all* the information listed in Regulation 23 must be included. Potential traps for trustees include:

- The **default arrangement** Statement of Investment Principles must be included in full and attached to the Statement. (This should be the latest version that has been signed, even if this occurred after the scheme year-end.) The actual date of the last review of the default arrangement must be shown and should be justifiable - for example, by including the date of the relevant trustee meeting or advice letter. It is important to clarify, with dates, whether the review covered both the investment strategy and the performance of the default arrangement, or if separate reviews were carried out. Details of the review and a full explanation of any changes that were made as a result (or during the scheme year) must be included.

- TPR's Quick Guide highlights a "common mistake" made by trustees in the section on **processing of core financial transactions** - not making it clear what action they have taken to ensure that processes and controls are in place to monitor the accuracy and timeliness of core financial transactions. TPR advises trustees to refer to the requirements of their service level agreement with administrators and their monitoring of compliance during the scheme year.

- In the assessment of **value for members of costs and charges**, the trustees must explain exactly why they think the charges and transaction costs are good value. It should be clear from the trustees' explanation that their assessment took into consideration the *quality* of the services, including (as a minimum) fund management.

- Detailed examples must be given of how the trustees have met **trustee knowledge and understanding** requirement (for example, demonstrating completion of the TPR's Trustee Toolkit) and, importantly, how this enabled them to exercise their functions. This must include TKU activities during the scheme year to which the Statement relates. The TPR Quick Guide is a useful reference point for what is meant by TKU.

As mentioned above in relation to TPR's updated guidance on reporting, the legislation on Chair's Statements does not allow discretion in relation to enforcement but TPR says it does not expect to be reviewing statements before Autumn 2020.

IV. Deadlines for fiduciary management and investment consultancy compliance statements

Obligations on pension scheme trustees to carry out compulsory competitive tenders for new suppliers of fiduciary management services and to set objectives for investment consultants have been in place since December 2019, under an Order from the Competition and Markets Authority

(CMA). The CMA has now published details about compliance statements and how to report non-compliance.

On 2 June 2020, the CMA published an update on the process and timing for compliance statements arising from its market investigation into investment consultants. The requirements are set out in the CMA's Order made on 10 June 2019 and effective from 10 December 2019. The Order contains the new requirements for pension scheme trustees to:

- carry out a competitive tendering exercise for appointments of fiduciary managers (for new appointments after 10 December 2019); and

- set "strategic objectives" for providers of investment consultancy services – this had to be in place by 10 December 2019.

For more details of the requirements, please see our Pensions Bulletin February 2019. Under the CMA Order, compliance statements by the various parties (including trustees) must be made to the CMA, confirming the extent to which requirements have been met, by the following deadlines:

- 8 July 2020, for fiduciary management providers in relation to performance information provision.

- 7 January 2021 for the other requirements, including trustees in relation to compulsory competitive tenders and objective setting for investment consultants.

If any parties (i.e. including trustees) are aware of any failure on their part to comply, they must report the non-compliance to the CMA within 14 days of becoming aware of the failure to comply and provide a brief description of the steps taken to address the failure.

DWP regulations that would replace the Order, published for consultation in July 2019, provide for TPR to carry out monitoring, compliance and enforcement. Instead of a compliance statement being sent to the CMA, trustees would be required to use the existing scheme return process to report compliance. However, there is no news on when these delayed regulations will be finalised. Unless and until the CMA regime is superseded by DWP regulations, trustees must use this process to report compliance.

V. FCA policy statement on DB transfers

The Financial Conduct Authority has published a policy statement on the DB transfer market. It includes the highly publicised steps to ban contingent charging, help for advisers and support for members who are considering whether to transfer out of a DB scheme, or who have transferred out.

The FCA's policy statement is a response to its recent consultation, which revealed that the proportion of customers who have been advised to transfer out of DB pensions is unacceptably high and that there have been too many cases in which transfers were not in the member's best interests. Of the 250,000 members who received advice during the period from April 2015 to September 2018, over 170,000 transferred, including 9,500 who did so against advice.

Contingent charging

The FCA will implement a ban on contingent charging (where a financial adviser is paid only if a transfer goes ahead), from 1 October 2020. The ban will apply unless the consumer can demonstrate that they are suffering from serious ill health or experiencing serious financial hardship. Advisers must consider an available workplace pension as a receiving scheme for a transfer and, if they recommend an alternative solution, demonstrate why that alternative is more suitable. The FCA will also implement proposals allowing advisers to provide an "abridged advice" process. This can result only in a recommendation not to transfer, or a statement that it is unclear whether a consumer would benefit from a pension transfer without giving full advice.

Suitability of advice

The FCA has published an update to its targeted supervisory work on DB transfers, looking at the advice firms have given. The FCA remains concerned at the number of files (17%) which either appeared to be unsuitable or where there were information gaps. It has produced an Advice checker for DB transfers for customers, containing information about the advice they should have received and on what to do if they received poor advice, as well as Considering a DB transfer - information for those who are considering transferring. The FCA will work with other organisations over the coming months to ensure easy access to this information.

The FCA's action on contingent charging is predicted to lead to a decline in requests for DB to DC transfers from October 2020. However, trustees should continue to follow the latest TPR guidance on communicating with members by providing appropriate risk warnings, encouraging members to take independent financial advice (in cases where the statutory requirement to take advice does not apply) and to ask questions of their IFA that will identify risks, and by highlighting the guidance offered by PensionWise. At the same time, they should be careful so as not to be seen as providing regulated advice. As mentioned above in relation to TPR's updated reporting guidance, trustees should continue to send the template letter to all members who request a CETV and monitor requests for CETV quotes.

VI. The Corporate Insolvency and Governance Act

The Corporate Insolvency and Governance Act received Royal Assent on 26 June 2020. The Act introduces measures to provide greater flexibility for companies to explore different rescue options and temporarily to protect companies from creditor action, including a new statutory moratorium and restructuring plan procedure.

There are two main pensions-related areas of concern - (1) the super-priority status for unsecured banking and finance debt and (2) the fact that neither the moratorium nor the restructuring plan count as a "qualifying insolvency event" for the purposes of the employer debt legislation or the Pension Protection Fund ("PPF") entry requirements, so that no debt is triggered and neither the trustees nor the PPF has a "seat at the table".

As a consequence of concerns raised by the pensions industry, the Government did amend the Bill before it was enacted to ensure that:

- It will not be possible for banks to accelerate payment of their debts during a moratorium, in such a way that the total amount of unsecured debt has super priority ranking ahead of the pension scheme.
- During a moratorium, the PPF will be given rights to information and the right to challenge the actions of the directors and/or the monitor.
- On a restructuring plan, both the PPF and TPR will be entitled to receive copies of all the information sent out to creditors.
- On both procedures, it will be possible to provide creditor rights to the PPF, subject to appropriate constraints.

VII. PPF compensation

The High Court has ruled that the cap applied to certain compensation paid by the Pension Protection Fund (PPF) is unlawful. While the Board of the PPF is considering its next steps, the judgment has potential wider implication than purely the amount of PPF compensation. It might, for example, impact the benefits provided for those schemes that have wound up outside the PPF, but with benefits cut back in line with the level of PPF compensation.

The judgment in *Hughes v Pension Protection Fund* was handed down on 22 June 2020. In broad terms, PPF compensation is assessed as 90% of the benefits fixed by the scheme for those members below normal pension age on the date when the assessment period for calculating the value of the scheme's assets began. In addition, for these members, there is an upper ceiling or cap on the compensation payable. This means that those who were below normal pension age at the start of the assessment period receive 90% of the amount of the compensation cap not 90% of the value of their accrued pension entitlement. There is no cap or 90% limit for members above normal pension age.

The cap was held to be unlawful on the grounds of age discrimination. Despite a number of arguments to the contrary, the difference in treatment for members under normal pension age was not found to be objectively justifiable. The compensation cap had therefore to be disapplied, and the claimants could seek to recover arrears of compensation from the Board for a period of up to six years.

There has been some speculation that higher compensation could give rise to higher future PPF levies, although the PPF has estimated that the removal of the cap would only increase liabilities by about 1%. Of course, those schemes that have fallen into the PPF with higher paid members with longer periods of service could be more greatly affected. As noted above, however, the level of PPF compensation is also relevant to the wind up priority where benefits cannot be paid in full.