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Pensions Update

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Pensions Regulator publishes DC communication guides

The Pensions Regulator (the "Regulator") has published the following guides, to be read alongside the DC code of practice:

- a quick guide to the chair's statement: this is drafted as a checklist of points to cover in the chair's statement, and includes helpful notes on what the Regulator expects to see, and examples of good practice. The guide takes account of the legislation that came into force this April about costs and charges information to be included and the new requirement to publish certain parts of the chair's statement on a members' website. ***This guide is of assistance to trustees, who can be held personally liable to pay a fine of £500 to £2,000 if a chair's statement does not comply with legislation;***
- a guide to communicating and reporting: this is divided into three sections:
  - knowing your members and seeking their views – this covers use of existing member data, member surveys and meetings, member representation etc.
  - communicating with members – this covers the need for clarity, review, responding to members' requests, as well as the approach to different types of communication, with examples and points on best practice; and
  - reporting – this section covers the chair's statement;

and the appendices include sample wording for generic risk warnings and member declarations.

Master Trust regulations and new guidance on "fit and proper" test

A master trust includes an occupational pension scheme providing money purchase benefits and in which two or more employers participate where not all of the employers are connected with each other.

The majority of the regulations relating to the authorisation of master trusts are coming into force on 1 October 2018. In anticipation of this date, the Regulator has provided further guidance to assist those schemes applying for authorisation, specifically addressing the requirement for a master trust to be operated by "fit and proper persons". All of the individuals directly involved with the scheme must meet this test, including the person establishing the scheme, the scheme funder, the trustee and any other individuals holding key powers. The guidance contains helpful examples of how to satisfy this "fit and proper" test.

Deadline for compliance with DC costs and charges requirements

As we reported in our February Update, various additional disclosure requirements relating to costs and charges within defined contribution occupational pension schemes were introduced in April 2018. Whilst the deadline for compliance with the new requirements will depend on a pension scheme's year end, for schemes with a year end of 6 April, the relevant deadline will be 6 November 2018 (i.e. 7 months after the end of its scheme year).

The new requirements include:

- the provision of information in the Chair's annual governance statement on the costs and charges for each default arrangement and each alternative fund option which the member is able to select (rather than just a report on the range of costs and charges);
- the compulsory inclusion of an illustration of the cumulative effects of charges and transaction costs on the value of a member's pension fund (in relation to both default funds and funds that members can themselves select within the pension scheme); and
- the publication of this information on a website.

The Department for Work and Pensions (DWP) has also recently issued new guidance for trustees on certain aspects of the new reporting requirements, which can be accessed here.

Pensions Regulator acts to address issues in smaller DB schemes

The Regulator has carried out new research which suggests that, whilst the majority of defined benefit schemes are well-run, smaller DB schemes are lagging behind.

The Regulator has commented that smaller schemes tend to demonstrate poorer governance standards, particularly in terms of assessing the fitness and propriety of new trustee appointments and also meeting the principles of the Regulator's funding code. To address this, the Regulator is increasing its proactive involvement with smaller schemes to assess their performance in key risk areas, including governance, covenant, investment and funding. Directive feedback will apparently be provided to a number of smaller schemes, and the Regulator has commented that its new approach to monitoring may lead to it using its powers against small schemes. The Regulator notes in its statement that it has already started work on a new DB funding code, as outlined in the Government's White Paper on DB pension schemes, which it hopes will introduce clearer funding standards to assist trustees and employers to agree positive funding outcomes. The Regulator's statement can be found here.

Response to consultation on insolvency and corporate governance reform published

The Department for Business, Energy and Industrial Strategy has published the Government's response to its March 2018 consultation on Insolvency and Corporate Governance reforms, which is intended to address some of the concerns that have arisen from recent high profile UK corporate failures, such as Carillion and BHS. The response contains proposals for reforming the insolvency framework in cases of major corporate failure, as well measures aimed at strengthening corporate governance in pre-insolvency situations.

Although the response is not directly aimed at pension schemes, it forms an important part of the wider context in which the Department of Work and Pensions is taking forward proposals in the DB White Paper, including the recent consultation on strengthening the Regulator's powers. Particular aspects of the response for scheme sponsors and trustees to be aware of are:

- ***proposed dividend reform*** - in response to concerns which were raised as part of the consultation, that companies could pay dividends even when in financial distress, the Government has said it will consider whether there is a case for the "comprehensive" review of the UK's dividend regime, as well as options for a proportionate strengthening of the existing framework. This will include looking at whether directors could provide stronger reassurances for shareholders and stakeholders that proposed dividends will not affect the affordability of any deficit reduction payments agreed with pension trustees, as well as a number of other aspects of the current framework in which dividends are paid. In response to calls for more transparency about how companies make capital allocation decisions, the Government has said that it expects that investor pressure and recently introduced new reporting requirements to lead to better reporting in this area, but has said that it will bring forward further measures "if necessary".

- ***strengthening shareholder responsibilities*** - the Government will look at ways to strengthen shareholder stewardship, including working with investors, the FRC and others to incorporate stewardship within the mandates given to asset managers by pension funds and other asset owners.

- ***improving the insolvency framework*** – the Government has said that it will take action to improve the insolvency framework in cases of major corporate failure, including introducing new penalties for directors of holding companies who do not give due consideration to the interests of the stakeholders of a financially distressed, large subsidiary when it is sold. The response also proposes changes to the package of measures designed to help companies in distress set out in the Government's "Review of the Corporate Insolvency Framework", published in May 2016.

The response does not require any immediate action to be taken by trustees or scheme sponsors in a DB pension context, but it does contain a number of points for scheme sponsors to be aware of, including the potential future reform to the UK dividend framework and confirmation that the Government will look to incorporate stewardship within the mandates given to asset managers by pension funds.

Further detail and commentary on the proposals can be found here.

Deadline for final decision in CMA review of investment services brought forward

Following its investigation into the supply and acquisition of investment consultancy and fiduciary management services in the UK, ***the Competition and Markets Authority has confirmed that it will now publish its final report by the end of 2018***, despite its statutory deadline for publication being 13 March 2019. This means that the deadline for the receipt of all parties' responses and submissions for consideration by the CMA before reaching its final decision will be 31 October 2018.

As we reported in our July update, the CMA has already published its provisional findings, including that trustees should run a competitive tender process when appointing their first fiduciary manager and that fiduciary managers should provide clearer information on fees and previous performance in order to facilitate meaningful comparisons.

Regulator provides more detail on what its changed regulatory approach will mean for schemes

In July 2017, the Regulator launched a programme called TPR Future, in which it set out its intention to become a clearer and tougher regulator. The Regulator has said that one of the key outcomes of this programme is that it will take a **"far more hands-on, supervisory approach, interacting with high risk schemes on a regular basis"**. As part of the continuing roll out of that programme, the Regulator has now provided further detail of what that new approach will mean in practice for workplace pension schemes and how it intends to implement its **"quicker, clearer and tougher"** approach to the regulation of workplace pension schemes.

Key points for trustees and scheme sponsors to note are:

- ***new one-to-one supervision for 25 schemes*** - the Regulator is launching dedicated one-to-one supervision of, initially, around 25 of the biggest DC, DB and public service pension schemes. This number will grow to more than 60 in the next year or so. The Regulator has not identified which schemes will be subject to one-to-one supervision, but notes that it will reflect their "size and strategic importance within the pensions landscape"; and

- ***heightened supervision for a further 50 schemes*** - the Regulator will also be using "higher volume supervisory approaches", such as letters, calls and emails with a further set of schemes. The Regulator has said that, from next month, this type of intervention will be piloted with approximately 50 DB schemes to assess compliance with messages in TPR's 2018 annual funding statement, specifically concerning whether schemes are being treated fairly when it comes to dividend payments to shareholders. The Regulator has said that "hundreds" of schemes will experience this approach over time.

The Regulator has stressed that the new approach is not about becoming more punitive, but about building closer and better relationships with schemes. Given recent proposals to introduce a more punitive regime in the DB White Paper and consultation on strengthening the Regulator's powers, and with continuing political pressure in the wake of recent corporate collapses and calls for concerns with the current regulatory regime to be addressed, setting the balance right will be challenging.

Schemes which are particularly large, and are likely to be considered high risk by the Regulator, should pay particular attention to the recent announcement as they may now experience the new regulatory approach. Trustees and scheme employers of all types of scheme should, however, also prepare themselves to see the volume and frequency of their interactions with the Regulator increase.

The full report can be viewed here. Further detail about the proposals in the DB White Paper and associated consultation on the Regulator's powers can be found in this article *Defined Benefit Pension Reforms: Tougher regulation, greater scrutiny*, written by members of our pensions team. This article first appeared in the September edition of PLC magazine.

Government moves forward with new investment and disclosure proposals

We previously reported on the proposed changes to the requirements governing Statements of Investment Principles ("SIP") prepared by trustees, which were put forward by the Government in June 2018. The Government has now confirmed that it will now move forward with the bulk of these proposals, with some adjustments to take into account concerns raised during the consultation stage. The key proposals which will now be implemented are set out below.

- the current requirement for trustees to take into account "*environmental, social or ethical considerations*", in the selection and realisation of investments, will be replaced with a requirement to take into account "*financially material considerations over the appropriate time horizon*". "Financially material considerations" will include, but will not be limited to, environmental, social and governance factors, including climate change. The revised requirement will also apply to the default strategy of DC schemes, subject to some limited exceptions. Schemes will also be required to set out their policies in relation to stewardship; and

- new requirements will, subject to certain limited exceptions, require trustees of DC schemes to publish their statement of investment principles together with a report on how they have implemented it.

The requirement to produce a separate statement on members' views before preparing a SIP is not being taken forward following practical concerns raised as part of the consultation. Instead, trustees of certain schemes will have the option (but not a requirement) of including in their SIP the extent (if at all) to which non-financial matters have been considered.

Trustees will need to ensure that they comply with the new requirements when they come into force. In preparation for this, they will need to consider how the new requirements apply to their scheme - this will depend on the type and size of scheme. The changes are coming into effect in stages, with the initial deadline for updating a SIP to take into account the revised requirement on financially material considerations coming into effect on and from 1 October 2019.

We will be discussing what this development means for trustees at our next Breakfast Briefing to be held at our offices on 6 November. Please speak to your usual Baker McKenzie contact if you are interested in attending.

Pensions Disputes News

BA trustees to appeal Court of Appeal decision

The trustees of the British Airways Pension Scheme have decided to appeal the decision of the Court of Appeal that the introduction of the discretionary increase rule to grant a 0.2% pension increase was invalid. We understand this follows requests from members, who have argued that the trustees would be in breach of trust if they did not appeal. The trustees have advised that they expect the appeal to the Supreme Court to be heard in the second half of 2019.

For further details on the Court of Appeal judgment, please see our July update.

DWP and Regulator issue guidance on Pensions Ombudsman dispute resolution functions

The DWP and Regulator have issued a joint letter, in which they clarify that all complaints and disputes about occupational and personal pension schemes should be sent to the Pensions Ombudsman and all general requests for information and guidance should be addressed to the Pensions Advisory Service. The letter also confirms that changes will be made to the legislation which contains the requirements to notify members of the relevant dispute resolution procedures when parliamentary time allows (probably by April 2020), and there is no compliance risk in the meantime if schemes wish to signpost the new arrangements to members.

The letter also highlights that members can use the new Early Resolution Service at the Pensions Ombudsman without first having to go through their pension scheme's own internal dispute resolution service (although a full internal dispute resolution procedure would normally have to be undergone before a member could bring a formal complaint to the Pensions Ombudsman).

A copy of the letter can be found here.

Pensions Ombudsman issues new guidance on redress for non-financial injustice

The Pensions Ombudsman has issued new guidance on fixed amounts which will be awarded to members for non-financial injustice (often referred to as awards for "distress and inconvenience") suffered as a result of maladministration in relation to their pension scheme.

The Ombudsman's new policy is that these types of awards will now usually fall into one of five categories: nominal, significant, serious, severe and exceptional. The amounts payable in each case vary from zero for a nominal award, up to more than £2,000 for an exceptional award. He has also provided guidance on the circumstances in which the various levels of award will be made. The guidance can be found here.

CJEU rules that Pension Protection Fund compensation is not adequate: Hampshire case

The Court of Justice of the European Union (CJEU) has ruled that European legislation requires every individual scheme member to receive old age benefits corresponding to at least 50% of the value of his or her accrued entitlements under an occupational pension scheme in the event of his employer's insolvency.

The compensation provided by the PPF is the means by which the UK has sought to comply with its obligations under European insolvency legislation. PPF compensation is subject to certain limits, including a 90% compensation level and cap for those under normal pension age. All members receive inflationary increases on pensions accrued but at a lower level and only in respect of qualifying employment after 6 April 1997. Previous decisions of the CJEU in Robins and Hogan found that employees must retain at least 50% of their entitlement to old age benefits where their employer becomes insolvent. However, the application of that test has been debated - in particular whether it should be conducted on an individual member-by-member basis or applied as an average across the relevant scheme. ***Until this decision, the PPF had taken the view that it is an average test.***

In this case, Mr Hampshire's pension scheme had entered a PPF assessment period after the insolvency of his former employer. The PPF had determined that the scheme was sufficiently well funded to provide benefits at or above PPF levels and so the scheme was wound up outside the PPF. However, Mr Hampshire saw a 67% reduction in his pension (including receiving minimal inflation protection because he left service in 1998) as a result of the application of PPF compensation levels through the compensation rules in the Pensions Act 2004. He brought a claim before the English Courts, which referred the matter to the CJEU.

The CJEU concluded that each member must receive at least 50% of their accrued entitlement on an individual basis. Furthermore, it did not matter that Mr Hampshire's scheme had ultimately not entered the PPF because the limits on his benefits reflected compensation rules set by a public body, the PPF, to which the Directive is directly applicable.

The case is legally significant as it means that the UK legislation does not wholly meet the EU requirement and will need to be updated to reflect the minimum 50% entitlement which the CJEU has now said must be provided.

The case will now revert back to the Court of Appeal, which is required to follow the CJEU's ruling.

In the meantime, the UK Government has said that it is carefully considering the implications of the judgment in conjunction with the PPF and will set out its response "in due course". The Government has not given any indication of when it will do this and the timing (and potentially, the Government's approach) is likely to be impacted by the outstanding court proceedings, as well as, potentially, Brexit negotiations.

In practice, the PPF has said that it expects the number of members affected by the judgment to be "very small" (on the basis that the vast majority of PPF members will already receive compensation in excess of 50 per cent of their accrued old age benefits). ***The judgment does, however, give rise to additional considerations for sponsoring employers and trustees in situations where they are calculating benefits by reference to PPF level benefits, such as where the scheme is winding-up outside the PPF.***

A copy of the full judgment can be viewed here and the PPF statement here.

Contact us

If you wish to discuss any of these issues further, please contact your usual Baker McKenzie lawyer.

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