Recent Developments in Pensions

Hogan Lovells Pensions Team

8 July 2021

What's New in DC?

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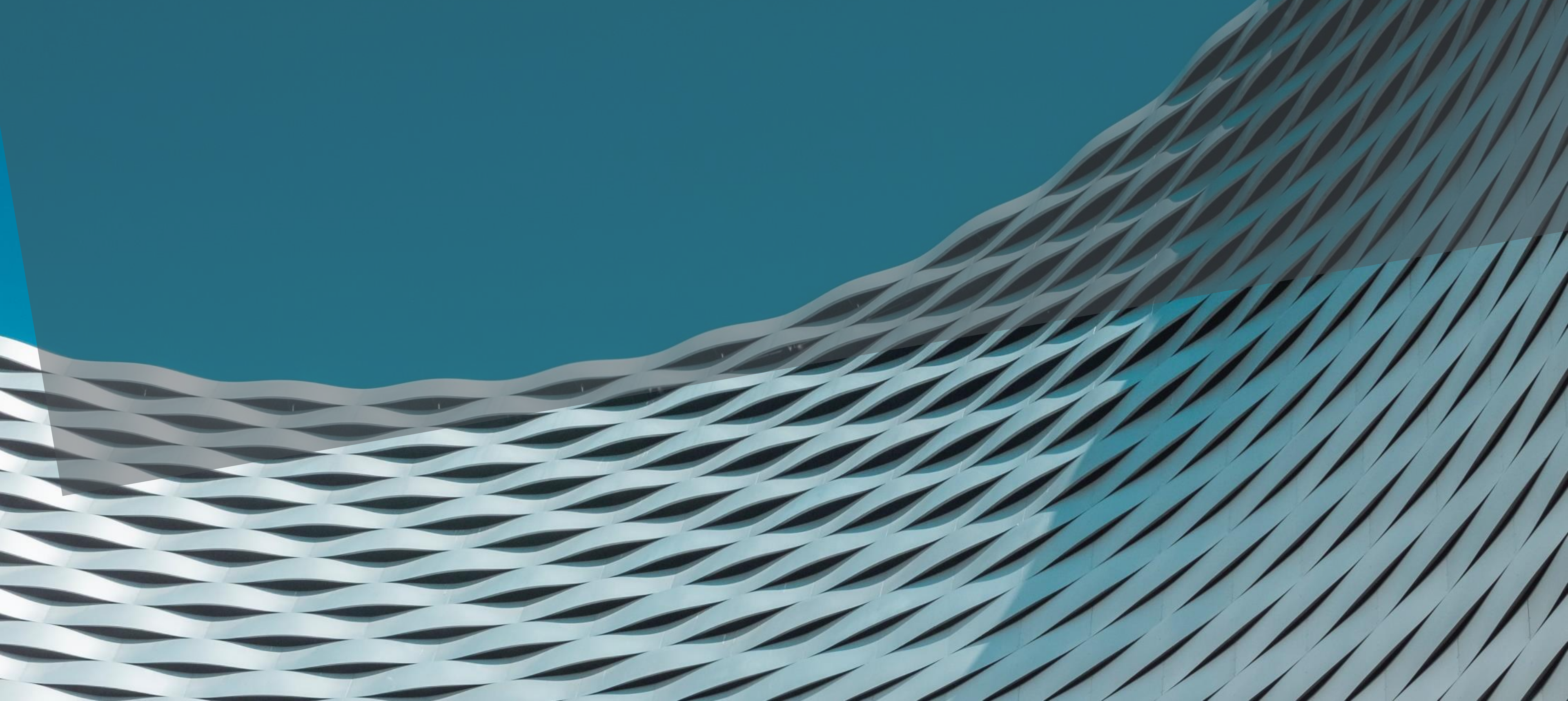
Simpler Annual Benefit Statements



Annual Benefit Statements: Draft Regulations and Statutory Guidance

- Simplifying statements for qualifying schemes used for auto-enrolment

- Apply where:
  - Scheme is AE qualifying scheme and provides only money purchase benefits; and
  - Member not yet drawn benefits

- Other schemes encouraged to adopt principles in statutory guidance on voluntary basis

- Expected in force 6 April 2022

Benefit Statements: Guidance and Template

- Must have regard to statutory guidance
- Fit on one double sided A4 sheet
- Includes basic template – information should be ordered and presented in five section to ensure consistency between schemes

1. Member and scheme details
    - incl anticipated or agreed retirement date
2. How much already in pot
    - incl signposting to costs and charges info, SIP, implementation statement
    - Costs & charges in £ encouraged but not required

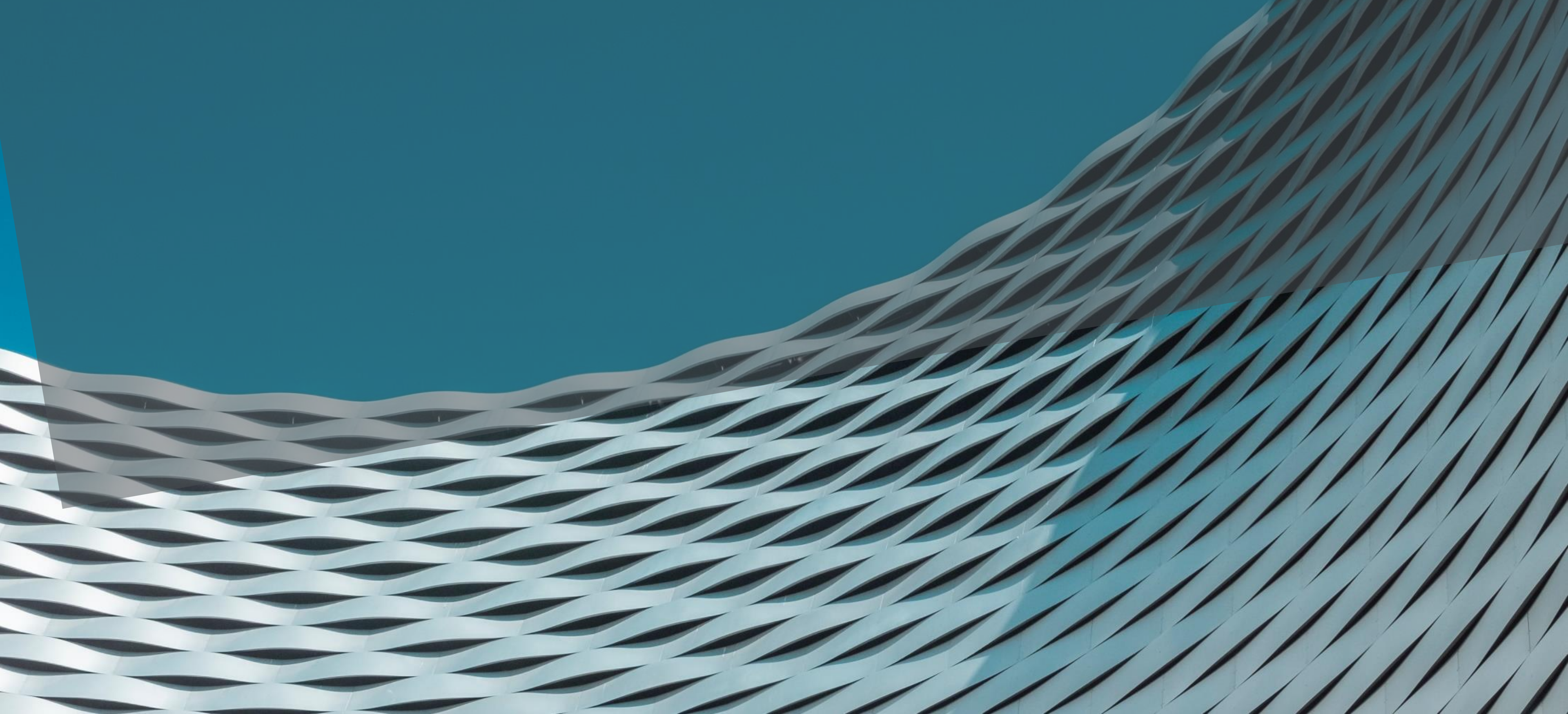
Template Sections cont'd

3. How much may have in pot on retirement
    - incl illustration and what may mean for retirement income
    - Information on assumptions and signposts to further information

4. What member may do to give him/herself more money
    - Eg, illustration of how increasing saving or delaying retirement could leave to greater pot

5. More about pension scheme and how member can use his/her money

Charges



DC Charges Cap: de minimis Ban on Flat Fees

- DWP consulting on ban on flat fee below de minimis level
    - De minimis initially £100, may increase in future

- Reminder: three permitted charging structures for default fund
    - Single annual funds under management charge ≤0.75%
    - Combined % contribution charge plus annual % charge on funds under management
    - Combined flat fee plus annual % charge on funds under management

DC Charges Cap cont'd

- Ban proposed from 6 April 2022

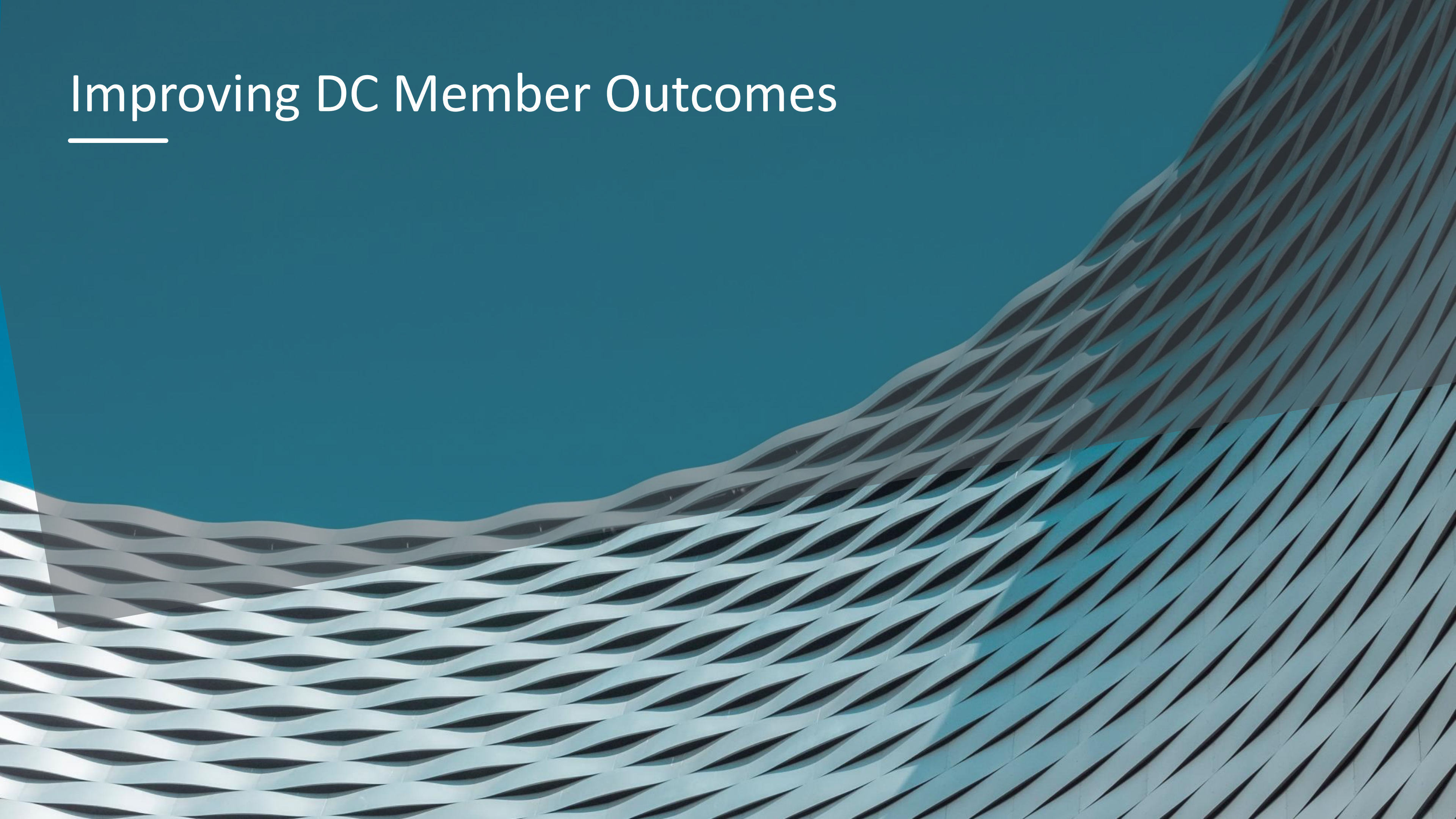
- All pots – active and deferred

- Percentage charge on funds under management applies on all default pots, regardless of size
    - Apply before any flat fee

- Flat fee may be charged if pot £100.01 or more but may not reduce pot below £100

- Member has multiple pots in same default fund
    - Combined pot value
    - Flat fee may be charged only once

Improving DC Member Outcomes



DC: Reporting Net Investment Returns

- New requirement to report net returns (after deduction of charges and transaction costs) for:
  - Each default arrangement
  - Each self select fund in which members' assets invested in year (regardless of whether open or closed to further contributions)

- For first scheme year ending after 1 October 2021

- Report in chair's statement

DC: Reporting Net Returns - Guidance

- Minimum: net return for scheme year
- Net returns for at least previous 5 years recommended (or reasons why not provided)
- “Annual geometric average”: annual net return which, when compounded, achieved return shown
- May decide to show return on £10k sum with no further contributions
- Show net returns for age 25, 45 and 55 where vary with age
- Where returns vary by employer, member should be able to identify return would have received

More on Costs & Charges

- Costs solely attributable to holding physical assets excluded from charges cap
    - Eg insurance, ground rent, management costs

- Performance fees may be smoothed over up to 5 years
    - Applies to first “charges year” ending after 1 October 2021.

Enhanced VFM for “specified schemes”

- DC schemes with <£100m assets operating for more than 3 years

- Enhanced value for money (VFM) assessment
  - Report to tPR in scheme return and include in chair’s statement
  - Covers: costs & charges; net returns; and governance & administration

- Applies for first scheme year ending after 31 December 2021

- Hybrid schemes
  - Total DB and DC assets counted for £100m threshold
  - Only DC assets subject to enhanced VFM

- Poor VFM: improve or wind up

Enhanced VFM: Comparisons with Larger Schemes

- Comparison of costs/charges and net returns with 3 larger schemes
    - At least one "must have had discussions" about potential transfer
    - Trustees should have "clear rationale" for choice of comparators

- Compare default arrangement with comparators' defaults

- Compare popular self-select funds with nearest comparable funds in comparators

- Net returns over short term (1 year) and longer period where data allows (preferably 5, 10 and 15 years)

Enhanced VFM: Seven Governance Metrics to be Met

- Promptness & accuracy of core financial transactions
- Record keeping
- Appropriateness of default investment strategy
    - Inc whether ESG/climate policies are tailored to investment strategy
- Investment governance
- TKU and skills
    - Inc diversity, effective decision making, working relations with employer/third parties
- Member communications
- Conflicts management

Enhanced VFM: Legacy Funds

- Legacy funds = funds with special features (eg DB underpin, GAR, with profits)
- Must be valued as part of VFM
- Default legacy funds to be compared to a range of default arrangements
- Not assume good value
- May be possible to transfer guarantees to new provider

Transfers and Pension Liberation: What's Changing?

Edward Brown
Partner, London
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Scams – Problems for Trustees

- Scams: money disappears, unauthorised payment charges, high fees/unrealistic investments

- Trustees are expected to be policemen…
  - Extensive expectations on disclosure of information
  - Telephone call with the individual if concerns flagged
  - Pension Ombudsman can reinstate members if “best practice” not followed

- But members’ have statutory right to transfer
  - To another registered OPS/PP
  - OPS fine as long as employed by anyone
  - Timescales to pay transfer

All Change…

- From 1 October 2021:
  - Members statutory rights/timescales etc still apply; but
  - Trustees can only pay a transfer if one of 4 conditions is met

- Need to inform members of the 4 conditions within 1 month of transfer request

- 3 of the conditions are easy…

Condition 1 – Low-risk Schemes

- Transfers to:
    - authorised MTs;
    - public service schemes; or
    - schemes supported by FCA-insurer

- Obligation on **transferring trustees** to check these conditions are complied with

Condition 2 – Transfer to OPS

- Transfer to OPS but only if there is an "employment link" as follows:
    - Member is employed by a participating employer and has been for 3 months;
    - Has been paid at least the LEL over the 3 months; and
    - Employer and member both have contributed to the scheme during the last 3 months

- Obligation on the **member** to provide evidence

- Trustees must decide, on balance of probabilities, whether the employment link is satisfied.

Condition 3 – Transfer to QROPS

- Transfer to a QROPS where a “residency link” is satisfied:
    - Member is resident in same jurisdiction as QROPS; and
    - The member has been so for continuous period of 6 months before the transfer request

- Again, obligation on member to provide evidence, and trustees to decide if residency link is satisfied

- No detail on “residency”

Condition 4 – Anything Else…

- Transfer to any other scheme, but only where:
  - No “red flags” are present; or
  - No “amber flags” or there are amber flags, but the member has taken advice from MPAS

- Red/amber flag deemed present if trustees “have a reasonable belief” that they are (note objective test).

Condition 4 – Red Flags

- The member has failed or refused to respond to a request to provide information
- The member has received advice from an unauthorised firm, or the member was recommended to transfer by someone who did not provide formal advice (save for certain overseas transfers);
- The member's request to transfer arose from unsolicited contact from the receiving scheme from someone previously unknown to the member;
- The member has been offered an incentive to make the transfer;
- The member has been pressured to make the transfer quickly
- There was an amber flag, the member was told to take advice, but they have not evidenced they have done so.

Condition 4 – Amber Flags

- High risk or unregulated investments in the receiving scheme;
- Unclear or high fees being charged;
- The investment strategies of the receiving scheme are "unclear, complex or unorthodox"
- The receiving scheme includes overseas investments, or an overseas adviser has advised the member in relation to such investments
- The Trustees are aware of a high volume of requests from the Plan to a particular scheme or via a particular adviser.

Takeaways

- Conditions 1 – 3 relatively easy to satisfy
- Condition 4 complex – is trustees’ belief “reasonable”?
- How much do you tell members about the tests in the notification?
- DWP guidance says you won’t need to ask the red/amber flag questions for Categories 1-3 – how does that compare with practice?
- DWP “expects” there will be Regulator guidance
- Will it make trustees’ task easier…?

Update from the Regulator

Rebecca Howard
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Agenda

- Annual Funding Statement
- Corporate Plan 2021-2024
- Final Regulations (Contribution Notices and Interview Powers)
- Draft Code 12 (Contribution Notices)
- Climate change governance consultation

Annual Funding Statement 2021

- Applies to Tranche 16: valuation date 22 September 2020 – 21 September 2021

- Will regulate in accordance with current scheme specific funding requirements and current DB funding code

- Encourages long term planning in approach to funding

- Recommends documenting management of key risks

- Tables of different scheme characteristics (as previous years)

Annual Funding Statement cont.

- Inflation:
  - RPI expected to be aligned with CPIH from 2030
  - Trustees with RPI linked increases should choose assumptions carefully for pre and post 2030

- Mortality
  - Opinions differ on long-term impact of COVID
  - Trustees who adjust mortality assumptions for COVID should be able to justify decision

Annual Funding Statement cont.

- Employer covenant
    - Recognises some employers impacted by Covid and/or Brexit
    - Stress testing/scenario testing beneficial – working from scenarios already considered by employer may be efficient approach
    - Employers expected to have detailed financial projections and updated business plans – tPR expects this to be provided to trustees where needed to assess covenant
    - Contingency plans expected where trustees identify adverse changes to covenant
    - Evidence of discussion with employer on key risks and options

- Deficit repair contributions
    - Reduction in DRCs for Covid should be short-term and include mitigation

Corporate Plan 2021-2024

- Follows recently issued Corporate Strategy

- DB funding
  - Second consultation latter part of 2021/22
  - Final revised code expected in place by December 2022
  - Valuations submitted under new guidelines from point new code in force

- Climate change
  - 2021/22 guidance on tPR’s expectations

- Dashboards
  - Scheme participation to be staged from 2023; timeline in secondary legislation in 2022

Corporate Plan cont.

- DB Superfunds
  - Legislative framework expected from 2022/23
  - Expects to consider clearance applications from some ceding schemes

- Administration and governance
  - tPR outreach programme with administrators in 2021/22
  - Equality, Diversity and Inclusion Strategy

- Other
  - Panel on master trust risks will manage an industry level tool to anticipate and track strategic risks in the master trust industry
  - Joint discussion panel with the FCA on cross-industry standards
  - Active role in tackling cyber risks and reviewing pension scams strategy
  - 2021/22 new scheme return portal will replace Exchange (in stages)

Final Regulations: Contribution Notices & Interview Powers

The Pensions Regulator (Employer Resources Test) Regulations 2021

- New “employer insolvency” and “employer resources” tests will only apply to acts (or failures to act) from 1 October 2021
- An employer’s resources for this purpose will mean the employer’s profits before tax, adjusted to exclude the effects of non-recurring or exceptional items
- tPR to have regard to the financial reporting standards relating to accounting practices issued by the FRC

The Pensions Regulator (Information Gathering Powers and Modification) Regulations 2021

- Mandatory information for notice requiring person to attend an interview
- If a criminal investigation, notice will confirm “witness” or “suspect” status
- Non-compliance:
  - Fixed penalty £400
  - Escalating penalty: daily rate of £200 (individuals) and (for corporates) daily rate starting at £500 then escalating at an additional £500 per day, to a maximum of £10k per day after 20 days

Draft Code 12: Contribution Notices

- Expected in force October 2021
- tPR may issue CN in reliance on more than one test

Circumstances in which tests could be met

- Removal/substantial reduction of sponsor support
- Weakening of scheme's position as creditor
- Some dividend payments or return of capital
- Favourable payments to other creditors

Actions which may fall within a test (absent mitigation)

- Sale of profitable sponsor and replacement with shell company
- Sale of sponsor's business
- Transfer of employees and pension liabilities to a weaker company
- Unnecessary insolvency, to enable purchase of business from administration
- Employer giving security to support group borrowings, without benefit to the employer
- Payment of a dividend to the employer's parent where the dividend exceeds the employer's net profit
- An employer in financial difficulty making an unscheduled repayment of an intercompany loan

Climate Change Governance Consultation

- Designed to help trustees meet tougher standards of governance in relation to climate change risks and opportunities, which apply to largest schemes from 1 October 2021

- Trustees not subject to new requirements may wish to follow guidance to improve governance standards

- Initial gaps in data expected – trustees to explain gaps and how they will try to fill them in future

- Appendix to Monetary Penalties Policy:
  - Mandatory £2,500 penalty for failure to publish climate change report on website
  - Discretionary penalties for other breaches
  - Failures in governance will be treated more seriously than failures to disclose

Recent *Axminster* Case

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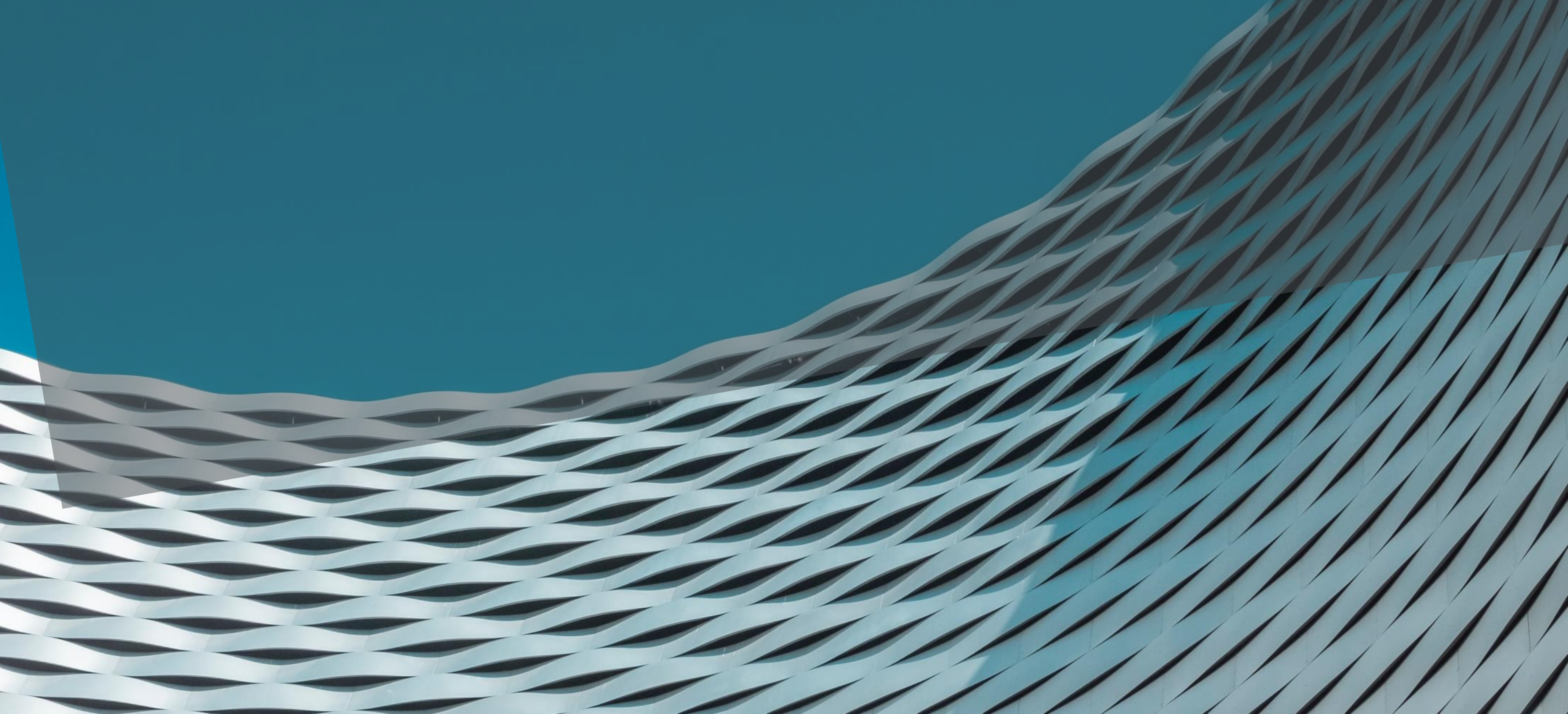
Background



The Axminster Case

- Recent High Court decision by Mr Justice Morgan (who gave judgment in Lloyds)

- PSGS v Jonathan Hazlett [2021]
    - PSGS: pension scheme trustee
    - J Hazlett: representative Defendant

- Builds on key issues considered in the Lloyds judgments with regard to pension arrears

The Plan

- Axminster Carpets Group Retirement Benefits Plan: DB scheme established in 1960s

- Axminster Carpets Limited
    - Producer of luxury carpets
    - Entered administration in February 2013
    - Now in liquidation (together with Plan's only other employer)

- Plan entered into PPF assessment period in March 2013

- PSGS appointed Trustee of the Plan at this time

The Issues

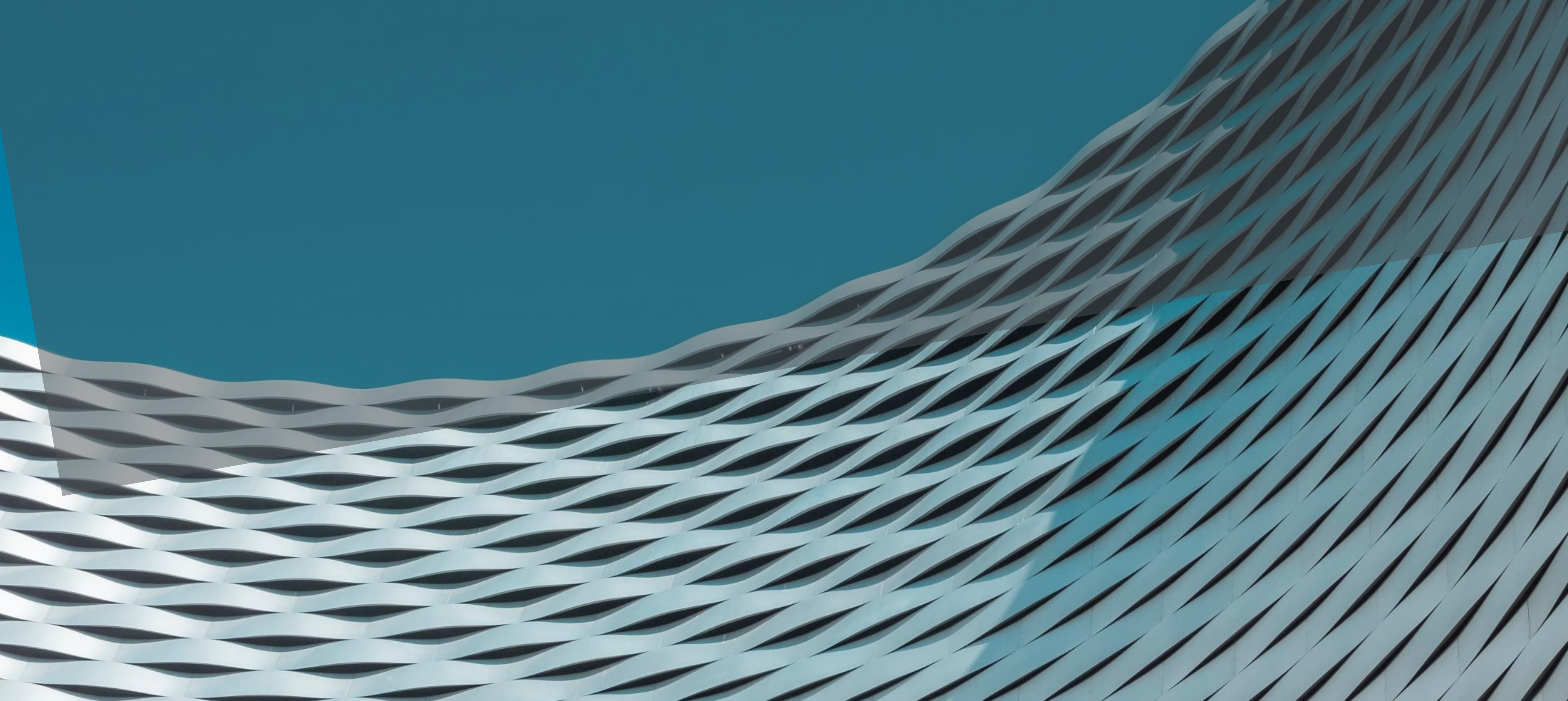
- PSGS concerned about the construction & validity of historic deeds altering the rate of pension increases under the Plan

- Initially sought directions from the Court, but a "compromise" was agreed instead

- This gave rise to questions re. the treatment of the resulting arrears:
    - Forfeiture provisions (including exercise of trustee discretion)
    - Limitation
    - Application of interest

- Section 37 PSA93: effect of non-compliance not considered

Forfeiture



Position in *Lloyds*

- Members entitled to equalised GMPs & pensioner members potentially entitled to arrears

- J Morgan held that scheme forfeiture rules applied to GMP uplifts
    - Pension instalments falling due more than six years ago forfeit
    - Did not matter that members didn't know they had any claim

- Also held that forfeiture rules were permitted under section 92 of the Pensions Act 1995

- Court in Axminster asked to consider two possible forfeiture rules

Rules in Axminster

Clause 25 – 1992 DDR

"POWER TO APPLY UNCLAIMED MONIES
ANY monies payable out of the Plan and not claimed within six years from the date on which they were due to be paid may (at the Trustees' discretion) be applied:

- *I. in augmenting the benefits of those Members still in Service,*
- *II. in reducing the Employer's contributions to the Plan, or*
- *III. in payment of the expenses of the management and administration of the Plan."*

Rule 36 – 2001 DDR

"Unclaimed Money
If a Beneficiary fails to claim a benefit within six years of its becoming due, it shall be forfeited but the Trustees may at their discretion … apply all or any part of such benefit:

- *a) to the Beneficiary notwithstanding the forfeiture;*
- *b) in augmenting the benefits of Members still in Service;*
- *c) in reducing the Employer's contributions to the Scheme under Rule 10; or*
- *d) in payment of the expenses of the management and administration of the Scheme."*

Court’s Construction

- Clause 25 1992 DDR:
    - No wording which directly deals with the forfeiture of an entitlement or a time-bar of claims
    - Likely intended for missing beneficiaries

- Rule 36 2001 DDR:
    - Expressly provides for forfeiture (but with discretion to re-instate)
    - Affirms Lloyds – can be applied to arrears
    - "Failure" to claim by the member: factual – does not require "blame" (but see later re. Trustee discretion)
    - "Benefit" relates to instalment of pension. Not sufficient to request pension at retirement

Exercise of Trustee Discretion

- Forfeiture rules can be "automatic" - the trustee has no say

- However, the forfeiture rule in the Axminster Plan was discretionary:
    - Benefits forfeit after 6 years; but
    - Trustee had discretion to apply for beneficiary anyway

- The Trustee asked for guidance on how that discretion should be exercised

Relevant Factors

- Trustee must consider relevant factors
- It is relevant that members are not to blame for the pension underpayments and trustee potentially open to some criticism:
    - Does not prevent operation of the forfeiture rule
    - But first reaction of the trustee should be to make good the earlier underpayments without further delay
- However there can be countervailing factors– e.g. administrative difficulties

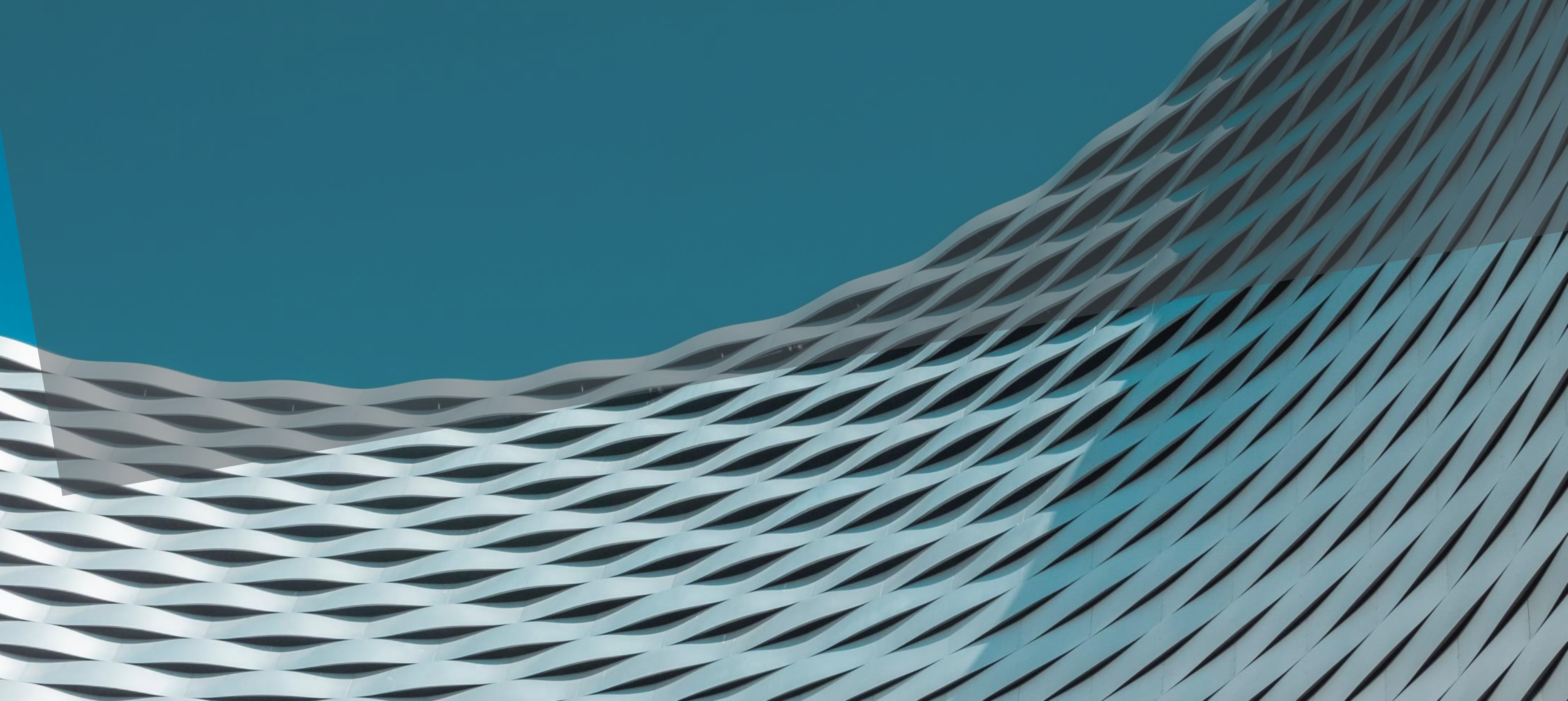
Introducing a Forfeiture Rule

- Court considered whether the introduction of Rule 36 under the 2001 DDR was valid under the Plan's amendment power

- This prohibited amendments which "would" diminish benefits already accrued

- Amendments fine because:
    - Benefits are unaffected unless failure to claim
    - So cannot say the change "would" diminish benefits, only that it "might"

Limitation & Interest



Claims Time-barred Statute?

- In brief, limitation for beneficiary claims under a trust:
  - 6-year limitation from date right of action accrued (when underpayment fell due)
  - But no limitation for an action by a beneficiary to recover trust property from a trustee

- Different possible claims:
  - Claim to recover underpayment (an "account" claim)
  - Breach of trust
  - Could have implications for interest (see later)

Limitation in Arrears Claims

- Claims vs. current Trustee
  - "Account" claim - recovery of trust property so no limitation period applies
  - Forfeiture rules still apply independently

- Claims vs. former trustees
  - Any breach of trust claims for arrears prior to 2013 would need to be made against former trustees
  - However can't be an action to recover trust property, so 6-year limitation period applies
  - Former trustees left office in 2013: claims now time-barred

Interest

- Court in Lloyds considered interest should be awarded in relation to GMP arrears

- Trustees ordered to pay simple interest at 1% above base-rate:
  - Compensation for being "out of money"
  - Court didn't consider the actual loss suffered (e.g. if arrears had been invested)
  - Influenced by fact that arrears likely to be modest in individual cases

- Axminster:
  - Court followed reasoning in Lloyds
  - Comments around the type of claim

Takeaways

Takeaways

- Axminster largely confirms the position in Lloyds, but issues considered in more detail
- Forfeiture clauses – effectiveness turns on the specific wording
- Strong steer towards re-instating benefits
- Arrears claims against trustee will not be time-barred under statute
- Member's entitled to interest – time period?

Any questions?

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