Hogan Lovells

Recent developments in pensions

Hogan Lovells Pensions Team

4 December 2020

Pension Superfunds

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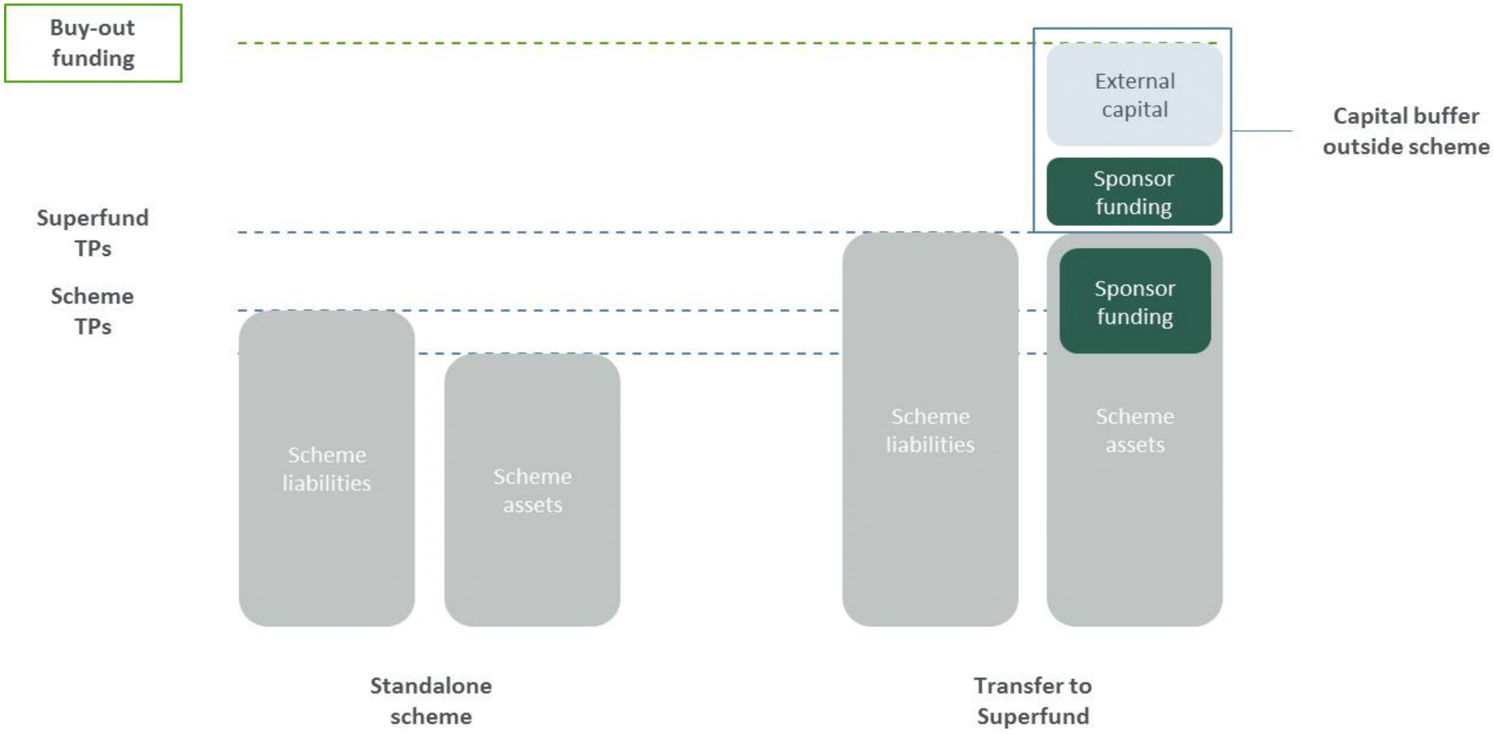
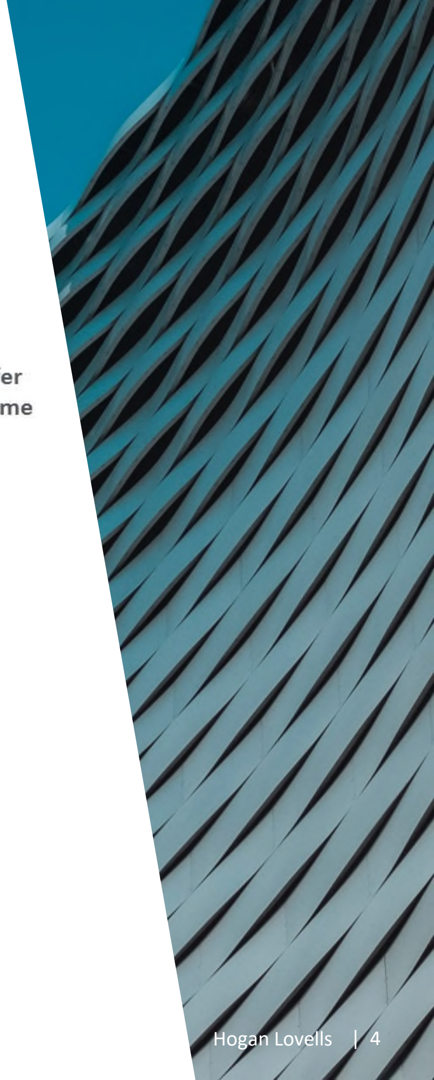
Superfunds – a reminder (1)

- Industry-wide DB scheme established as a commercial operation
- OPS, HMRC registered, subject to pension legislation, eligible for PPF
- Supported by capital provided by private investors
- Allows employer to withdraw from involvement with the scheme



Buy-out funding
Superfund TPs
Scheme TPs
External capital
Sponsor funding
Capital buffer outside scheme
Sponsor funding
Scheme liabilities
Scheme assets
Scheme liabilities
Scheme assets
Standalone scheme
Transfer to Superfund



Superfunds – a reminder (2)

- 2 main providers:
    - Clara: “bridge to buy-out”. Separate segregated sections per scheme with separate capital. Buy-out generally within 10 years.
    - Pension SuperFund: assets co-mingled together; synergies and efficiencies; opportunity to share in surplus for members.

- Benefits & risks?
    - Allows employers to break from the scheme for lower than buy-out cost
    - Potentially great opportunity for trustees concerned about viability of employer
    - Capital buffers
    - Risks of benefits not being paid?
    - Fundamentally a good thing – risks in not transferring?

Regulatory regime?

- Idea has been around a long while – but TPR prohibited any transfers until it had guidance in place

- Pension Regulator guidance:
  - For superfund providers on 18 June 2020
  - For trustees & employers considering a superfund transfer on 21 October 2020

- Likely an authorisation regime will be in place in a few years. But transfers can occur before then

Regulator guidance – superfund structure

- Basic benchmark: 99% probability of benefits being paid in full
- Prudence: for TPs and appropriate security structures for the capital
- Extraction of value: initially (next 3 years) no extraction of surplus from Superfund or buffer unless benefits bought out in full with insurer, and provider fees have to be fair and reasonable
- Corporate backer “fit and proper person” and with appropriate financial resources
- Low risk funding trigger:
    - If total assets (Superfund scheme assets plus buffer assets) falls to TP level
    - All funds in buffer transfer to pension scheme under control of trustees (unless additional capital injection)
- Wind up trigger:
    - If total assets fall to 105% of PPF liabilities
    - Must wind up and transfer members out

Regulator guidance – process for transfer

- Transfer is a Type A event – clearance expected

- Gateway principles:
  - Scheme can't afford buy-out now, and has "no realistic prospect" of doing so in "foreseeable future" (5 years)
  - Must improve likelihood of members receiving full benefits

- Role of trustees:
  - it's their decision!
  - take professional advice (paid for by employers) and do proper DD
  - consider alternative options
  - consider any past significant corporate activity for any material detriment

- Member communications
  - Open and transparent
  - Explain why this is expected to improve member outcomes
  - Any member options exercise associated with it should follow industry best practice

GMP Equalisation: are we there yet?

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The Courts

October 2018:

- Must equalise for the effects of GMPs relating to the period 17 May 1990 – 5 April 1997
- Various methods approved (B, C2 and D2)
- Need to correct for the past as well as for the future
- Time limits

May 2020:

- Liability for past (unequalised) transfers out
- Top up or residual pension (how calculate)
- Time limits

October 2020:

- Judge has asked for an additional hearing to discuss transfers

November 2020:

- Judgment on transfers out delivered

LLOYDS BANK

The final instalment of the Lloyds Bank case

The judge held that:

- Historic transfer values should have been calculated on a basis that equalises for the inequalities caused by Guaranteed Minimum Pensions (if service 1990 - 1997)
- Schemes which did not do so still owe an obligation to the former member to make a top up payment (no residual benefit)
- The top up is to be calculated as at the date of the original transfer plus interest
- No time limit and forfeiture rules did not apply
- Formal member discharges were not effective
- Top up payable to receiving scheme
- Possible to pay to the former member or to compromise the claim
- Bulk transfers without consent on mirror image terms – obligation on receiving scheme

Role of Trustees

Question 4(f)
"Is the Trustee under an obligation proactively to identify and calculate any shortfalls in previous transfers out and take steps to equalise them, or is the Trustee entitled to wait until a request is made by the receiving scheme or by the transferred-out member?"

Answer
.. the Trustee does need to be proactive in that it must consider the rights and obligations which I have identified, the remedies available to members and the absence of a time bar and then determine what to do.

What might happen in practice?

- Expect schemes to continue with GMP equalisation for existing members

- Check availability of transfer out data – the three "Rumsfeld" buckets:
    - **Bucket 1** – known knowns - Recent transfers out where full information available
    - **Bucket 2** – known unknowns - Historic transfers where only partial data available
    - **Bucket 3** – unknown unknowns -Transfers out where no data exists (change of administrators/GDPR)

- Availability of historic transfer out assumptions/data – actuarial assistance

- Bulk transfers mirror image vs service credits (don't go there!)

Bucket 1 – Recent Transferees (known knowns)

- Review member file – amount transferred (Amount A)
- Calculate transfer value for “comparator” (Amount B) using same basis
- If Amount A >= Amount B no further action
- If Amount B> Amount A then top up required (B-A plus interest)
- If top up required contact former member and either:
    - Ask for details of receiving scheme to pay top up; or
    - Agree to pay lump sum “relevant accretion” to former member
- If transferred to a defined benefit scheme should the top only be paid to the receiving scheme (avoid double bubble!)

Bucket 2 – Partial Data cases (known unknowns)

- Identify what data are missing
- Use a tracing service to find former member
- Contact member and ask for information to complete missing data
- Alternatively consider offering a compromise payment eg:
  "You transferred out of the Scheme in [2005] – the Scheme no longer holds sufficient data to calculate whether a top up payment is due. If you are able to provide us with missing data then we will be able to calculate whether there is any top up payment due. Alternatively, to save time and administrative fees the Scheme is prepared to make a payment to you of £[ ] to settle any claim you may have."
- Need to consider tax position of the payment – may be paid by employer

Bucket 3 – unknown unknowns

- No option but to await contact from former members
- When approached by a claimant:
    - Request information (questionnaire NI number, employment dates etc)
    - Request evidence (member statements, transfer forms etc)
- Consider information and evidence (review with employer)
- Consider offering a compromise payment
- Could the Scheme make a charge for admin expenses, refundable if person found to have been a member with 1990/1997 service
- Might this become a new area for PPI claims

Schemes winding up

- Run off insurance unlikely to cover GMPe for transfers out
- Usually transfers out are not covered by “residual risk” insurance
- Section 27 Trustee Act 1925 adverts might protect against bucket 3
- Limitation periods may be different for scheme winding up
- Employer indemnity
- Delay winding up timetable or continue the scheme as a “shell” whilst GMPe for transfers out dealt with

Additional thoughts

- Judgment may have wider implications for transfers out:
  - Males who transferred out before Barber window closed
  - What will the Pension Protection Fund do for schemes that have transferred
  - Transfers from schemes where mistakes are not rectified
  - What to do for members who have died leaving no personal representatives

- Position of the receiving scheme:
  - Defined benefit – Coloroll obligation on receiving scheme
  - How to equalise transferred in benefits
  - Defined contribution/personal pension – Judge did not clarify

- GMP Equalisation Industry Working Group will issue updated guidance on transfers (and include example of anti-franking calculation)

Cybercrime

Faye Jarvis
Partner, London
Pensions

*“As well as **billions of pounds of assets**, with millions moving around regularly from member to scheme bank accounts, employers and fund managers, pension schemes have an **abundance of member data** which are also **attractive assets for a criminal**. In addition, for pension scheme sponsors, there is the added risk of **reputational damage** from their pension scheme being impacted by a cyber-attack, which could also **increase scheme deficits**.”*

Institute and Faculty of Actuaries
November 2020

Why does cyber security matter?

- Trustees have a legal obligation to have adequate internal controls in place to manage risk
- Cyber crime is a rapidly evolving, serious threat
- Increase in sophistication – undertaken by criminal businesses
- Pension schemes hold large amounts of data and assets so are a "target for fraudsters and criminals"
- Need to understand cyber risks and include on risk register
- Links in with GDPR but is different

> It's not a case of if you will be attacked, it's a case of when.
>
> *David Fairs, tPR*

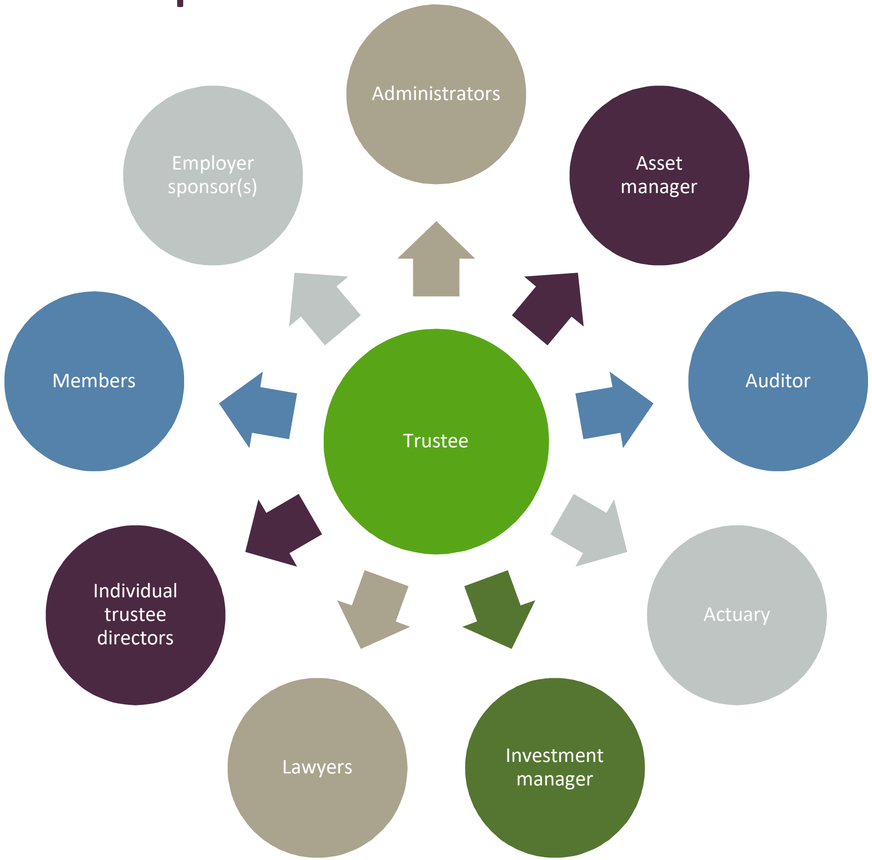
Types of cyber risks faced by pension schemes

- Ransomware attacks
- Malware attacks
- Phishing
- Distributed denial of service (DDOS)
- Cyber theft and fraud
- Data theft

What impact could an attack have?

- Service interruption
- Loss or disclosure of member data
- Regulatory action and significant fines
- Ombudsman complaints or litigation
- Time and financial costs to the Fund
- Reputational damage externally
- Investments – inability to place trades
- Direct impact on pensioners if payments are disrupted
- Reporting obligations
- Credit monitoring for affected members
- Members/other beneficiaries defrauded
- Remediation costs to address breaches

Trustee cyber footprint



Practical steps to manage risk

- **Personal IT security**
  - Use strong passwords
  - Ensure have up to date virus protection in place

- **Regular training**
  - Cyber risk is always evolving – ensure have at least annual training to keep up to date and ensure policies remain appropriate
  - Work through scenarios

- **Carry out appropriate checks on service providers**
  - On appointment – diligence what controls they have in place
  - Regular reporting – results of any penetration tests, changes to key security procedures, renewal of compliance certificates, training for staff
  - Ask questions - eg: how do they ensure payroll can still be run if there is an attack? How quickly can they recover member addresses?

Practical steps to manage risk (cont)

- **Adopt an incident response plan**
  - The Pensions Regulator expects trustees to have one
  - Delegate authority to a response team
  - Information and guidance on questions to ask and when to notify
  - Draft crisis communications
  - Record log

- **Check whether any insurance covers cyber risk**

- **Ensure robust processes in place for key transactions**
  - Changes to bank account details
  - Providing instructions to investment managers

Key takeaways

- Trustees have responsibility to manage cyber risk – can’t just rely on service providers to do it for them

- Trustees should adopt a cyber security policy (including incident response plan - Regulator requirement)

- Draw on employer resources where possible

Transferring to a Mastertrust

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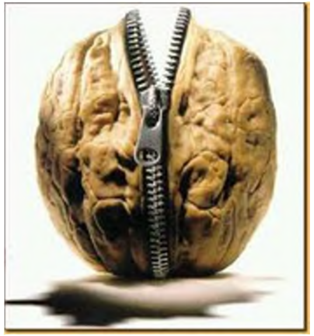
Pensions

Overview of the session…

- What is a Mastertrust and why are employers looking at them?
- Understanding a transfer to a Mastertrust . . .
- Trustee role including (1) key consideration and (2) some tricky issues to grapple with

What is a Mastertrust arrangement?

What is a Mastertrust?



- In a nutshell:
  - Occupational pension scheme
  - Members are employed by different unconnected employers
  - DC arrangement

- Used as an alternative to Group Personal Pension Plans
  - Big uptake as a result of auto-enrolment

- Concerns raised about the lack of regulation - system of authorisation and regulation under the Pension Schemes Act 2017

Why are employers keen?


REGULATIONS
GUIDELINES
COMPLIANCE

Other reasons…

Overall member experience?

Better technology?

Better investment choices?

Better performance ?

More focus on DC – not distracted by DB?

“Blue chip” operators?

Improved communications?

More retirement options?

Costs?

Regulated product?

Understanding a transfer to a mastertrust . . .

The basic structure

Mastertrust provider - founder

Mastertrust trustee

Mastertrust administrator

Occupational Pension Scheme
Governed by Trust Deed and Rules

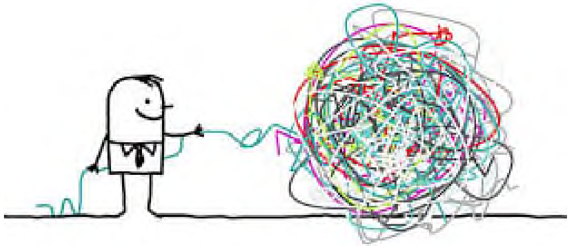
Company

Company

Company

Company

Untangling a transfer…



- Employer participates in a mastertrust . . .

- New employees: admitted to mastertrust for future contributions

- Existing members of occupational scheme:
  - Admitted to mastertrust for future contributions
  - Stop receiving DC contributions in the occupational scheme
  - Have their accrued DC pots transferred to the mastertrust

- Existing members may be DC only or have DB benefits and a DC pot.

Trustee role

What does the Trustee need to agree?

- Employer can do some of the process without the Trustee but co-operation is needed for existing members:

  - Stop receiving contributions in the occupational scheme
    - **Amendment power:** usually needed to stop future DC contributions to the occupational scheme

  - Have their accrued DC pots transferred to the mastertrust
    - **Transfer power:** to transfer the DC pots without consent to the mastertrust

Using the amendment power

- Check the power allows the amendment
- 60 day consultation to stop accrual as it’s a “listed change”
- NB should be no s67 issue

Using the transfer power

- Check transfer power permits non-consent transfer

- Legislation permits a non-consent transfer if:
  - pure money purchase benefits

  AND
  - to an “authorised” mastertrust

  AND
  - Members given 1 months notice

- Terms of the transfer – set out in a transfer agreement

All rests on the Trustees agreeing that this is in members' best interests!

If not, shouldn't exercise the amendment or transfer power

Key considerations for Trustees – is it in members' best interests?

Should the Trustee agree?

- Our expectation is that Trustees would usually be able to agree but detailed process required – driven in part by DWP Guidance

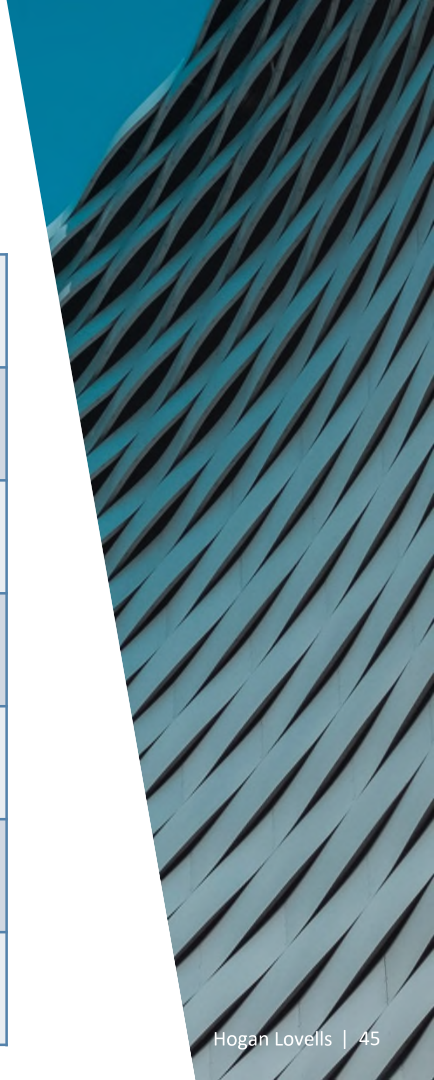
- Trustees expected to undertake detailed due diligence
    - features of the mastertrust compared to the occupational scheme
    - DWP suggests that trustees use DC template for both schemes
    - expected to understand impacts on different groups – including those not transferred!

- DWP guidance acknowledges that this is a balancing act!

- Makes sense for Trustees to be involved from the outset AND needs to be supported with advisers (and budget) but on “no-obligation” basis!

Due diligence on the mastertrust

Size, current membership and time established	Quality of Administration
Scheme governance and management	Quality of communications – including modelling tools
Investment options – including default strategy - and range of funds	Security of assets
Benefits options	Legal powers
Costs of the transfer	Technology
Ongoing charges	Ability to support RAS
Value for money	Performance record



Some tricky issues . . .

Costs higher in the mastertrust . . .

- Trustees need to understand:
    - Transfer costs members may incur
    - Ongoing costs
    - Whether employer will meet any costs

- Harder decision if members will incur higher costs

- **BUT** Trustees can take a holistic view and DWP guidance makes clear it can still be appropriate to transfer members who will incur higher costs

Fund mapping and charges cap . . .

- Trustees need to consider where members funds should be transferred to ie a similar fund

- Will need to take specialist advice on what is appropriate for members

- Consider impact of default arrangements and charges cap

Transfer triggers a S75 debt . . .

- Some DC employers in the occupational scheme may have previously been DB employers
- Will trigger a S75 debt when they stop making contributions
- Trustee may be asked to agree to an FAA to facilitate

Occupational scheme uses DC pots for tax free cash . . .

- Usual in occupation schemes for DB members to use DC pots to fund tax free cash at retirement

- DC pots being transferred to mastertrust!

- Solution is to allow DB members to bring back their DC pots at retirement:
  - Amend occupational scheme rules to give a right to members
  - Ensure mastertrust rules allows a transfer back to the occupational scheme

- Beware tPR’s statements on Chairs statements . . .

Death benefits . . .

- Mastertrust may not provide death benefits

- Employer will need to make alternative arrangements

Issue 1

- If a DB scheme may ask Trustee to continue to provide

- BUT s255 of the Pensions Act 2004 . . .

- Safest course is to provide separate insured arrangements

Issue 2

- Potentially 2 sets of trustees administering benefits – need to ensure co-ordination obligations built in to the Participation Agreement

Tax protections . . .

- **Some tax protections can be lost on a transfer:**
  - Protected pension age
  - Lump sum rights
  - NB we would expect enhanced and fixed protection not to be an issue as the transfer should be a "permitted transfer"

- **Protection preserved if "block transfer"**
  - All the member's rights have to be transferred at the same time
  - Problem if you transfer DC pots out of occupational scheme with DB benefits

- **Solutions**
  - Check if members have these – may not be relevant
  - Transfer back benefits at retirement mechanism could also be used!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Any questions?

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