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What's Happening in Pensions

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Pension protection levy 2017/18

The Pension Protection Fund **has published**, though only provisionally, its pension protection levy determination and accompanying appendices and guidance for the 2017/18 levy year. It has also published its **policy statement**.

The PPF's documents include the rules for certifying and recertifying contingent assets (eg, guarantees) in order to reduce a scheme's levy. These rules are unchanged. This year's deadline is 31 March 2017.

The PPF is keeping the determination provisional while it considers introducing special rules for schemes without a substantive sponsoring employer following a restructuring. There will be a consultation about that shortly. No other changes are expected in the final version, which will be published by 31 March 2017.

There are no changes of substance from the draft documentation published in September 2016 (see **WHiP Issue 60**). That means that there are still only the following material points to note.

- **FRS 102 accounting standard:** This new standard can have an unwarranted effect on insolvency risk scores for some employers who use the large and complex or not-for-profit scorecards. It can lead to the inclusion or exclusion of new items in the relevant accounting line for the first time (so-called "change variables") and result in a changed score without there being any different understanding of employer strength. There is therefore a mechanism for affected employers to certify an adjustment to Experian.

- **Parent companies filing small companies accounts:** The PPF has become aware that there are around 20 companies which, although they file small companies accounts on a consolidated basis, are the parents of employers. The large and complex scorecard is not well suited to measuring such companies as it uses data items not included in small companies accounts, typically resulting in a poor score. The PPF considers that it would be more appropriate for these entities to be scored on the "independent small" scorecard (as they already are, for the purposes of their own score, if they are employers).

The consultation on rules for the next levy triennium (2018/19 to 2020/21) will begin shortly. There are likely to be more significant changes proposed then.

Select Committee report on DB pensions

The House of Commons Work and Pensions Select Committee has published its **report on DB pension schemes**. It makes recommendations for changes to legislation and the regulatory regime. The report is intended to influence the Government's thinking as it prepares to issue a green paper on this subject.

Key proposals are as follows:

- The Government should consult on empowering the Pensions Regulator to impose punitive fines of up to treble the amount that can be imposed under a contribution notice or financial support direction. The intention would be that such fines would act as a "nuclear deterrent" to the avoidance of funding obligations.

- Trustees should be able to demand timely information from scheme sponsors (for example, information about a proposed restructuring before it is agreed).

- The Government should consult on proposals to enable trustees, subject to Regulator approval, to:

  - consolidate small schemes in an aggregator fund to be managed by the PPF, creating economies of scale for both schemes and the Regulator; and

  - agree changes to the indexation of pension benefits in instances where such changes are needed to make a scheme sustainable, including conditional arrangements that will revert to original uprating when economic conditions improve.

- The Regulator should be permitted to wind up a scheme if it is satisfied it would be in the best interests of the PPF and its levy payers, and that no alternative option is realistically available to deliver a better outcome for members.

- Scheme members should be given greater flexibility to take small DB pensions as lump sums.

- The scheme valuation process should be improved:

  - the timetable for valuations should be flexible - shorter or longer - to reflect risk; and

  - the statutory timescale for the submission of valuations and recovery plans should be reduced from 15 to nine months.

- Recovery plans of more than ten years should be exceptional.

- The PPF should consult on means of adjusting the calculation of the pension protection levy to:

  - reduce the levy for schemes with good governance; and

  - ensure particular types of employer, including SMEs and mutual societies, are not unfairly disadvantaged.

- The Regulator should take a more active approach to its involvement in the negotiation of regulated apportionment arrangements (under which "section 75" employer debts can be reallocated to another scheme employer or employers, with Regulator approval). The Government should consult on streamlining the process and amending the requirement for insolvency to be imminent and inevitable.

- There is a strong case for Regulator clearance to be mandatory where there is the greatest risk of material detriment to pension schemes. The Government should consult on rules regarding the size of the pension deficit relative to the value of the company and the viability of the ongoing plan for supporting the pension scheme as the basis for a mandatory clearance when corporate changes could damage a pension scheme.

EMIR clearing exemption

The European Commission **has announced** that it has adopted a **delegated regulation**, which would extend again the transitional period during which IORPs and other pension scheme arrangements are exempted from the EMIR mandatory central clearing requirements. These apply to certain derivatives transactions used to reduce investment risks and liabilities.

If the EU Council and European Parliament do not object, the exemption will apply for a further year, ie, until 16 August 2018. The exemption was introduced in order to avoid pension schemes having to realise illiquid assets in order to post cash (or other liquid) collateral with central counterparties. Doing so would increase schemes' costs and could adversely affect scheme members.

We understand that the European Commission is preparing to propose a more permanent solution to this issue for pension funds.

Bulk DC transfers without consent

The Government has issued a **call for evidence** on how to improve the current rules on the bulk transfer of DC pensions without consent from occupational pension schemes (and stakeholder schemes). The aim is to make it easier to consolidate DC schemes, whether via a merger or by making a bulk transfer to a master trust.

The Government notes that the bulk transfer without consent provisions in the preservation legislation were drafted with DB pensions in mind. They require a "broadly no less favourable" actuarial certificate and that the two schemes or sponsoring employers have a specified relationship with each other. The Government asks, without firm proposals of its own, for suggestions of a more suitable regime for DC transfers.

The Government acknowledges that there is a separate issue with the Pensions Act 2004 requirement, which applies on a TUPE transfer where the original employer had an occupational pension scheme, that the new employer must offer an occupational pension scheme or stakeholder scheme. Employers are not able to satisfy this requirement by offering a group personal pension arrangement (though there will often be no adverse consequences if they do). This issue is out of scope of the present call for evidence (because an amendment to the statute, rather than regulations would be needed) but the Government is happy to hear views on the issue.

Responses should be submitted by 21 February 2017 but amendments to legislation are not expected to take effect until April 2018.

IORP II directive

The new "IORP II" EU directive has been formally adopted and **published** in the Official Journal. (IORP stands for "institution for occupational retirement provision" and includes UK DB and DC occupational pension schemes.) EU member states have until 13 January 2019 to transpose the directive's requirements into national legislation, to the extent that it does not already comply.

This directive replaces the 2003 IORP directive, which informed many aspects of the Pensions Act 2004. Most of the existing directive's provisions are retained but there are some new requirements, as outlined below.

Directives are not directly applicable law (except to public sector bodies): they require national implementing legislation. It remains to be seen the extent to which the Government considers that UK law does not already comply. Also, of course, the January 2019 implementation deadline falls shortly before the UK is expected to leave the European Union. It therefore also remains to be seen whether, or to what extent, the Government will proceed with implementation.

The key points to note about the directive are as follows:

- **Scheme funding:** The directive includes no new provisions on funding or solvency. Indeed the development of further rules is ruled out. A recital says:

  > *"The further development at Union level of solvency models, such as the holistic balance sheet (HBS), is not realistic in practical terms and not effective in terms of costs and benefits, particularly given the diversity of IORPs within and across Member States. No quantitative capital requirements - such as Solvency II or HBS models derived therefrom - should therefore be developed at the Union level with regard to IORPs, as they could potentially decrease the willingness of employers to provide occupational pension schemes."*

- **Cross-border schemes:** The requirement for cross-border schemes to be fully funded has been watered down. It now requires that, in cases of underfunding, *"... the competent authority of the home Member State shall promptly intervene and require the IORP to immediately draw up appropriate measures and implement them without delay in a way that members and beneficiaries are adequately protected"*.

  A recital confirms that the mere fact that members or other beneficiaries reside in another EU member state (eg, pensioners living in Spain) does not make the scheme a cross-border scheme.

  There are also provisions on regulating cross-border transfers.

- **ESG factors:** Various provisions will require trustees to consider and make statements about their environmental, social and governance (ESG) policy, in the context of investment decisions and risk management. For example, the statement of investment principles will have to cover this. Member states must *"allow IORPs to take into account the potential long-term impact of investment decisions on environmental, social and governance factors"*.

- **"Fit and proper" trustees:** People who run an IORP should be fit to do so. This means that they should collectively have adequate qualifications, knowledge and experience. They should also be "proper", meaning of good repute and integrity. "Professional" qualifications will be required of people who carry out actuarial or internal audit functions.

- **Risk assessments:** IORPs will be required to have risk management and internal audit policies. Much of the detail here is left to national legislation or regulatory requirements. IORPs must also carry out and document a risk assessment at least every three years. Among other things, this must cover:

  - how conflicts of interest with the sponsoring employer are prevented, if key functions are outsourced to it;

- an assessment of the risks to members and beneficiaries relating to the payment of their retirement benefits; and
- "a qualitative assessment of the mechanisms protecting retirement benefits, including, as applicable, guarantees, covenants or any other type of financial support by the sponsoring undertaking, insurance or reinsurance ... or coverage by a pension protection scheme, in favour of the IORP or the members and beneficiaries".

- **Disclosure of information:** There will be new requirements for the disclosure of information to members, prospective members and other beneficiaries. These include:
  - an explanation of the impact on members and beneficiaries of significant changes to the technical provisions used to value the IORP's liabilities;
  - (for members and prospective members with DC benefits) information on charges and on investment performance for at least the last five years; and
  - "concise" pension benefit statements containing prescribed information. This includes information about the scheme's funding level. Projected levels of retirement benefits should include an unfavourable scenario that is "extreme but plausible".

As with the existing IORP directive, member states may choose not to apply the directive to IORPs with fewer than 100 members but some requirements must be applied to IORPs with more than 15 members. The investment provisions cannot be disapplied for any IORP.

Discriminatory protections for older members

An Employment Tribunal **has ruled** that the Government failed to objectively justify protections given to judges who were within ten years of retirement when changes were made that give lower pension accrual to younger judges.

210 judges claimed that the protections for older judges unlawfully discriminated against them directly on grounds of age (and indirectly, in some cases, on grounds of sex and race). The Government sought to justify any unlawful discrimination by reference to a legitimate aim of protecting those closest to retirement from the financial effects of the changes. This was dismissed as circular, since age and closeness to retirement is the same thing. The Tribunal also found the protections illogical in that older judges were least, not most, adversely affected by the changes.

The Tribunal heard that no specific analysis of judges' pensions was done and it rejected the argument that consistency across the public sector was a legitimate aim. In doing so, it found that there was no identified social policy objective and that there were already many inconsistencies between the pension arrangements for judges and for other public sector workers.

Although the Tribunal then did not need to decide the question, it also expressed the view that the protections had not been shown to be a proportionate way of achieving the Government's aim, since no evidence had been put forward as to why lesser protections, a shorter protection period or a higher qualifying age would not have met the purported aims.

This decision only covers the objective justification issue, so it is possible that the Government will raise other arguments in a separate hearing. There may also be an appeal.

The same Employment Tribunal is currently considering a similar claim by younger members of the Firefighters' Pension Scheme.

Trusteeship and governance

The Pensions Regulator **has published** a **response** to its consultation on 21st century trusteeship and governance (see **WHiP Issue 59**).

The Regulator takes the view that it is unacceptable that some members are at greater risk of poor outcomes in later life purely because they happen to have been employed by an employer with a poorly run pension scheme. It is determined to drive up standards of governance and trusteeship through:

- *"more targeted education and tools to raise the standards of poor trustees*
- *setting out clearly what we mean in practice by the higher standards we already expect of professional trustees and the specific qualities and skills we expect chairs to bring to trustee boards*
- *tougher enforcement against trustees who fail to meet the required standards"*

There are no new governance or administration standards proposed but we can expect (among other things) the following:

- clarification of the definition of "professional trustee" as part of a consultation on the Regulator's penalty policy;
- extensive guidance on good investment governance for all pension schemes (building on the current DC guide);
- consolidation of some guidance into key overarching guidance; and
- a fresh education campaign.

The Regulator will give further consideration to whether a "fit and proper" regime, including barriers to being a trustee (or trustee director) may help. (The IORP II directive (see above) is clearly relevant here.) It also wants to consider reporting requirements for DB schemes and, particularly for small DC schemes, to take steps to encourage consolidation.

Financial Services Compensation Scheme

The FCA has published a **consultation paper** about the Financial Services Compensation Scheme (FSCS). The paper looks principally at the funding of the FSCS but the FCA is also considering some changes that would affect occupational pension schemes and their members.

Whilst there is no cap on compensation for annuity holders, there is a £50,000 cap for drawdown products (unless they are structured as insurance contracts). The options proposed to address this include increasing the FSCS compensation cap for all investment business, perhaps up to £1 million (in line with the standard lifetime allowance).

The FCA is also proposing to bring consistency to the circumstances in which the FSCS can compensate participants in collective investment scheme (CIS) when an authorised fund manager or depositary is in default. Under current FCA rules, only some of the CIS activities of fund managers and depositaries are covered. The FCA proposes to close this gap by allowing the FSCS to "look through" a claim by a CIS (or any intervening fund operators, managers, depositaries or trustees) against an authorised fund manager or depositary in default, to enable it to compensate the underlying CIS participants.

The deadline for responses is 31 March 2017. Any changes are likely to take effect in April 2018.

Automatic enrolment

The Government has announced some details of its 2017 automatic enrolment review (via a **written statement** and **press release**). It will consider:

- policy objectives;
- the position of those who are not currently automatically enrolled, such as individuals with several jobs, each of which pays them less than the £10,000 pa earnings trigger, and the self-employed; and
- the scheme quality requirements (but changes to the DC minimum contribution requirements are not expected).

The Government has also confirmed that the automatic enrolment earnings trigger will be held at £10,000 pa for 2017/18. The qualifying earnings band figures for 2017/18 will be increased to £5,876 and £45,000 pa (ie, they will remain aligned with the National Insurance lower and upper earnings limits).

Financial guidance

The Government has issued a **consultation paper** on its proposals for a single public financial guidance body.

The Government announced in October 2016 (see **WHiP Issue 60**) that it had decided to combine the functions of the Money Advice Service (MAS), the Pensions Advisory Service (TPAS) and Pension Wise in a single body. The consultation paper says that the combined body will be launched no earlier than autumn 2018.

Comments are to be submitted by 13 February 2017.

Master trusts

The **Pension Schemes Bill** has been amended in the House of Lords to require the Government to establish a "funder of last resort" for master trusts that cannot meet their winding-up costs. This was an opposition amendment that the Government opposed, so the Government may seek to overturn it in the Commons.

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If you wish to discuss any points arising from this note, please speak to your usual contact in the Travers Smith Pensions team or to one of the Pensions partners: Susie Daykin, Daniel Gerring, David James, Dan Naylor, Paul Stannard and Philip Stear.

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