CLIFFORD CHANCE

UK: PENSIONS UPDATE - MARCH 2018

Contents

1. Pensions White Paper

The Government published its pensions White Paper last week. This sets out the Government's proposals for reforms to the regulation of defined benefit (**DB**) schemes and follows the Green Paper published last February.

Key points include the following:

- **DB regulation**

  Previous suggestions that clearance might be made mandatory on certain corporate transactions are not being pursued. Instead, the Government intends to legislate in areas which would support or enhance the existing regulatory regime (e.g. it will review the notifiable events regime to look at the range of events and timing for notification and is considering a new requirement for sponsoring employers/parent companies to make a statement of intent (in consultation with trustees) prior to certain business transactions taking place - this would require confirmation that the sponsor/parent has appropriately considered the impacts of any DB scheme affected and mitigated any detriment).

  The Government also plans to introduce new powers to punish those who deliberately put schemes at risk, including punitive fines for contribution notice targets (including individual directors) and a new criminal offence for directors or connected persons for "wilful or grossly reckless behaviour" in respect of the DB scheme (a fairly high threshold). A formal consultation in this area is expected "in the coming months".

- **Scheme funding**

  There is to be a revised DB funding code which will focus on what "prudence" and "appropriate" mean in a funding context and which will require trustees and employers to agree funding in the context of (what we expect to be) an agreed long term funding objective. There are also proposals for DB schemes to appoint a chair who must give a chair's statement in order to report (to the Pensions Regulator) on key scheme funding decisions as part of the valuation process. All or part of the new DB funding code would be mandatory, so that the Regulator can enforce it and issue sanctions / penalties for non-compliance.

  It appears the Regulator will start work and informal consultation on this with the industry this year, with formal consultation on the revised code to follow.

- **DB consolidation**

The Government is keen to encourage this, though it is clear that the fundamental characteristics of any new consolidation vehicles (including funding and investment requirements, employer support and Pension Protection Fund (**PPF**) eligibility) will need to be worked through in detail. Consultation on this is not expected to happen until later this year.

Any legislative changes following consultation in the various areas are unlikely to be made before the 2019-2020 parliamentary session, at the earliest.

The White Paper was swiftly followed by the launch of the Department for Business, Energy & Industrial Strategy's consultation paper setting out proposals to improve the UK's corporate governance framework, focusing on companies which are in or approaching insolvency. The consultation is seeking views on a number of measures, including new measures to hold directors of parent companies to account in certain circumstances where they decide to sell a large insolvent subsidiary, new powers to enable the reversal of inappropriate extractions of value from companies in financial difficulties and extending the scope of the Insolvency Service's powers.

2. GDPR reminder as May deadline approaches

As reported on in our December edition, the new General Data Protection Regulation (**GDPR**) will take effect in the UK and other EU Member States from 25 May this year, introducing a new regime for the protection of people's personal data.

While the aims of the new regime do not differ from those of the current regime, the GDPR will introduce new concepts and some enhancements to the protections for individuals which will likely require pension scheme trustees to alter their existing processes.

In practice, if trustees already have robust data protection measures in place, the GDPR will not necessitate a complete overhaul of these. However, the new requirements of the GDPR mean that action in a few key areas will need to be taken before 25 May. Key actions, if not taken already, are likely to include:

- Arranging training from advisers to gain a good understanding of the new GDPR requirements and what needs to be done.
- Talking to third party service providers to gain an understanding of what personal data they hold and the arrangements in place to ensure personal data are protected.
- Reviewing existing contracts with third party service providers who process personal data on the trustees' behalf and agreeing amendments to ensure compliance with the new contractual requirements imposed by the GDPR.
- Arranging for new data privacy notices to be prepared and sent to members.
- Considering the basis on which the processing of "sensitive personal data" (e.g. health data) is justified and updating ill-health information request / consent forms as necessary where relying on consent.
- Reviewing and updating existing data protection policies and procedures and producing an updated data protection policy to document these.

Please see our December edition for more details.

3. New deferred debt arrangement to be introduced from 6 April

As reported on in our May edition, last year the Department for Work and Pensions (**DWP**) consulted on new regulations to amend the employer debt regime for multi-employer DB schemes.

The consultation proposed to introduce a new option for managing section 75 debts which arise on the occurrence of an "employment-cessation event".[1] The DWP published its response to the consultation last month, together with the finalised regulations[2], which will come into force on 6 April 2018.

1 Broadly, the date on which an employer in a multi-employer DB scheme ceases to employ any active members, at a time when at least one other employer (who is not a DC only employer) continues to employ active members.

2 *The Occupational Pension Schemes (Employer Debt and Miscellaneous Amendments) Regulations 2018.*

The new regulations will introduce a new "deferred debt arrangement" which will enable an employer, on an employment-cessation event, to defer payment of its section 75 debt and continue to remain on the hook as a statutory employer (becoming a "deferred employer" under the new regulations).

Deferred debt arrangement requirements

A number of requirements will need to be met to enable an employer to make use of the new option. In particular, that:

- the trustees have consented in writing;
- the scheme is not in a PPF assessment period or being wound-up;
- the trustees are satisfied that a PPF assessment period is unlikely to commence in the 12 months following the date on which the arrangement is expected to take effect; and
- the trustees are satisfied that the deferred employer's covenant is not likely to weaken materially in the 12 months following the date on which the arrangement is expected to take effect.

The requirement in the draft regulations for the funding test[3] to be met has been dropped on the basis that it is not necessary or appropriate as the deferred employer will remain on the hook as a statutory employer. This has been replaced with the fourth requirement set out above.

The final regulations now also explicitly set out the circumstances in which a deferred debt arrangement will terminate and the consequence in each case.

The finalised regulations give the trustees a wide power to subsequently terminate the deferred debt arrangement (and trigger the section 75 debt) if reasonably satisfied that: (i) the deferred employer has failed to comply materially with its duties under the scheme funding regime; (ii) its covenant to the scheme is likely to weaken materially in the following 12 months; or (iii) it has failed to comply materially with its disclosure duties under the *Occupational Pension Schemes (Scheme Administration) Regulations 1996*. In addition, if the deferred employer wishes to terminate the arrangement and trigger the section 75 debt, it must agree this with the trustees. (In the consultation response, the Government frames this as a move away from the position in the draft regulations to obtain "trustee consent", commenting that "mutual agreement" is more appropriate, although it is difficult to see the practical difference).

These provisions may mean this new option is unattractive to employers given the level of control afforded to scheme trustees (and the lack of prescription regarding the phrase "weaken materially").

Grace period

The final regulations also amend the notification period that employers have to write to trustees to seek permission to use the period of grace[4] from two to three months. Employers in a period of grace will also be able to enter into a deferred debt arrangement under the new regulations.

4. New regulations on bulk transfers without consent of contracted-out rights come into force on 6 April

Following the abolition of salary-related contracting-out in April 2016, it has not been possible for a scheme which has never previously been contracted-out to accept a without-consent bulk transfer involving contracted-out rights. In practice, this has had the potential to cause issues for a number of restructurings and transactions, including scheme mergers and demergers and any other strategy involving the transfer of contracted-out rights without member consent (given that it is not now possible to establish a new scheme on a contracted-out basis).

This issue will now be addressed, with new regulations coming into force on 6 April 2018. The regulations[5] will enable transfers of contracted-out rights without the consent of members from a formerly contracted-out scheme to a scheme which has never been contracted-out, provided certain conditions are met. Essentially these are that:

[3] The funding test is used in some of the existing options for managing section 75 debts where the responsibility passes to other employers. The test evaluates whether the remaining employers in the scheme will be able to satisfactorily fund the scheme.

[4] A mechanism whereby an employer can postpone its employment-cessation event if planning to employ an active member in the following 12 months (or 36 months, with trustee agreement).

i. the rights to be provided by the receiving scheme are, broadly, no less favourable than the rights which would have been provided under the transferring scheme. (The transferring scheme actuary will be required to certify this in the same way as is currently required for other bulk transfers without consent under regulation 12(3) of *the Occupational Pension Schemes (Preservation of Benefit) Regulations 1991*); and

ii. the contracted-out rights to be provided by the receiving scheme must be similar to those which a formerly contracted-out scheme would have provided in line with the appropriate legislation as it had effect at the time. (This replaced the requirement previously proposed in the consultation paper for the transfer to "*not adversely affect the rights*" of transferring members, which respondents had flagged was unclear in terms of how this would be assessed and by whom).

5. New cost disclosure requirements for DC trustees

As reported on in our December edition, the DWP has been consulting on proposals to impose new requirements on trustees regarding the disclosure of costs and charges.

The DWP published its response to the consultation at the end of February and the new regulations[6] will come into force on 6 April 2018.

The new requirements

The regulations will apply to trustees and managers of occupational pension schemes which provide defined contribution (**DC**) benefits (other than just additional voluntary contributions, and subject to some limited exceptions).

Requirement	Description	Timing
Extension of the DC Chair's annual statement	Requirement for statement to cover: • information about the level of charges and transaction costs applicable to **each** default arrangement and **each** fund that members are able to select (rather, than just information on the **range** of costs and charges, as is currently required); and • an illustrative example of the cumulative effect over time of the application of charges and transaction costs on the value of a member's money purchase benefits.	Requirement applies to statements prepared for scheme years ending on or after 6 April 2018. Statements must be completed within 7 months of scheme year end. (So the first schemes affected – whose scheme year ends on 6 April 2018 – will have until 6 November 2018).
Publication on website	Requirement to publish the above parts of the Chair's statement on a publicly available website free of charge. Details of the website must also be included in members' annual benefit statements. (As a minimum, trustees should include a brief explanation on what information is available, a link to	As above, within 7 months of first scheme year-end falling on or after 6 April 2018.

5 *The Contracting-out (Transfer and Transfer Payment) (Amendment) Regulations 2018.*

6 *The Occupational Pension Schemes (Administration and Disclosure) (Amendment) Regulations 2018.*

	the website and how to access this)	
Disclosure on pooled funds	Requirement to prepare and disclose on request a statement covering certain information on pooled funds.	Requirement comes into force on 6 April 2019. To be prepared and disclosed on request from members / recognised trade unions within two months of request (only one such request may be made within each six-month period). Information must be no more than six months out of date at any time. Annual benefit statements must also refer to how this information can be obtained.

One of the issues raised during the consultation was the practicality of publishing the information on a public website given that some schemes may not operate or have access to a public website. The DWP has not provided much additional guidance on this; stating that it should not be an "insurmountable" issue for schemes and indicating that websites run by other organisations, such as service providers, could be used.

Statutory guidance to support schemes has been published alongside the regulations. This will be reviewed at least every 3 years.

The Financial Conduct Authority will consult on parallel disclosure rules for workplace personal pension schemes later this year.

6. New regulations on bulk DC to DC transfers without consent

As reported on in our December edition, the DWP has been consulting on proposals to amend the requirement to obtain an actuarial certificate for bulk transfers of occupational DC to DC pension schemes without member consent, and replace it with an alternative test and new member protections. (The changes will not apply to DB schemes or DC schemes which include guarantees).

The DWP published its response to the consultation at the end of February and the new regulations[7] will come into force on 6 April 2018.

The new regulations

Under the new regulations, trustees will need to assess the suitability of the receiving scheme. A bulk transfer will be permitted if either:

i. the receiving scheme is an authorised master trust *or the transfer is between connected schemes* (a change made following consultation); or

ii. the trustees have consulted with a professional who they have verified to be independent.

The regulations will also extend charge cap protections for those transferred.

Following consultation, the independence requirement has been watered down to ensure trustees are able to find someone who meets the requirement to advise. In particular, the adviser must not have provided advisory, administration or investment services (rather than *any* work) to the receiving scheme, service provider, or sponsoring employer (or a connected firm) in the past year (rather than the past 5 years).

7 *The Occupational Pension Schemes (Preservation of Benefits and Charges and Governance) (Amendment) Regulations 2018.*

Designed to encourage scheme consolidation, the new measures are likely to be welcomed. However, there are a number of related issues which have still not been addressed – in particular, the issue of how members' protected rights regarding tax-free lump sums greater than 25%, protected pension ages and protected Lifetime Allowances would be treated. The consultation response refers to these issues being passed on to the relevant policy owners.

The regulations come into force on 6 April 2018 and the DWP says it is working with stakeholders and the Pensions Regulator to provide high level guidance for trustees by the end of April.

Note that the current option (enabling a bulk transfer where the requisite actuarial certification has been obtained) will be retained until 1 October 2019 to allow bulk transfers already in progress using this method to be completed.

7. Government publishes consultation response on master trust authorisation and supervision regime

The DWP has published a response to its consultation on draft regulations governing the regime for regulating master trusts from 1 October 2018.

The DWP confirms that, despite requests from the industry to narrow the scope of the master trust regime, it does not propose to introduce any new full exemptions from the regime. Amongst other things, the DWP also confirmed that:

- in mixed benefit schemes, the application for authorisation should include the required information which relates only to the DC aspects of the scheme, subject to certain limited exceptions.
- the proposed fee levels for authorisation will be a flat fee for new master trust schemes of £23,000 and a flat fee for existing master trust schemes of £41,000.
- it had been mindful of the requirements of the IORP II Directive (which needs to be implemented into national law by 13 January 2019) and that, where appropriate, the requirements have been reflected in the draft regulations (although other legislation will also be necessary to achieve full implementation and proposals in other areas will be published for consultation in due course).

The Pensions Regulator yesterday published its draft master trust Code of Practice for consultation. Consultation will run until 8 May 2018. The Regulator also plans to publish guidance to accompany the Code.

8. High court hands down judgment in BT RPI/CPI case

The High Court handed down judgment in the BT case earlier this year – the latest case concerning RPI/CPI and whether the scheme's rules permitted a switch away from RPI.

It was decided that the wording of the rules did not permit a switch from RPI to another index. As with previous cases, the findings in this case are specific to its facts and very much dependent on the drafting of the particular scheme's rules. The findings are therefore unlikely to be directly applicable to most schemes.

The rules

There were five sets of rules to be considered, but the key issues for determination turned on the 2016 and 1993 rules:

2016 rules	Provided for increases to be made in line with the "*increase in the cost of living*". *"The cost of living will be measured by the Government's published General (All Items) Index of Retail Prices* ***or if this ceases to be published or becomes inappropriate****, such other measure as the Principal Company, in consultation with the Trustees, decides*."
1993 rules	Provided for increases in line with "*the lesser of 5% and the percentage ratio...by which the index figure of the General Index for the month of January… in the year in which the increase takes effect exceeds the index figure for the same month in the immediately preceding year*." "*The "****General Index****" means the General Index of Retail Prices for all Items in the*

	Digest of Statistics published by the Central Statistical Office." "***If the General Index ceases to be published, or is so amended as to invalidate it in the view of the Principal Company as a continuous basis for the purposes of calculating increases****, the Principal Company shall substitute such other index or appropriate basis of comparison as it shall in consultation with the Trustees decide*.

(emphasis added)

The decision

The case focused on whether RPI has **become inappropriate** for the purposes of the 2016 Rules. The judge decided that the natural meaning of the language points to it being an objective test and therefore one for the court to decide. As to whether or not RPI had become "inappropriate", the court took the view that it was not enough that it would be better to use another index, or that another index has become *more* appropriate. "*The hurdle is a high one*." In the court's view, RPI had <u>not</u> become inappropriate.

Regarding the 1993 rules and the reference to RPI being "*so amended as to invalidate it as a continuous basis for calculating pension increases*", this would only be engaged by a change in the status of RPI i.e. it having been de-designated as a National Statistic was not enough (nor would be a change in the views of commentators as to the validity of RPI). It would require something like a change in the formulation of RPI.

BT has been granted permission to appeal to the Court of Appeal.

9. The new EU Benchmarks Regulation and what it means for trustees

New rules under the EU Regulation[8] on financial "benchmarks" began to apply from 1 January this year. The Regulation imposes new requirements on firms that provide, contribute to or use "benchmarks". "Benchmarks" is defined widely and covers a wide range of interest rate, currency, securities, commodity and other indices and reference prices.

Amongst other things, the Regulation imposes new obligations on regulated entities that are "users" of benchmarks, including: (i) a prohibition on using benchmarks that are not administered by an EU authorised / registered administrator (or a non-EU administrator that benefits from one of the third country regimes under the Regulation); and (ii) a requirement to put in place written contingency plans to cater for the future risk of material change to a benchmark / it ceasing to be published and to reflect such plans in contracts.

Whether this has an impact on pension schemes will depend upon whether or not they are considered "users" of such benchmarks under the Regulation. "Use" has a specific definition under the Regulation, which is different from the everyday meaning and pension schemes should not be considered users of benchmarks merely by virtue of holding investments which reference a benchmark.

Particular scenarios where the position is less clear are, for example, if pension scheme trustees are party to OTC derivative contracts or other financial contracts that reference a benchmark to determine the amount payable under the contract. Or, where trustees measure the performance of an investment fund through an index or a combination of indices for the purpose of tracking the return of such index or combination of indices, of defining the asset allocation of a portfolio, or of computing the performance fees.

However, in such cases, it is expected that trustees' investment managers would be carrying out these activities on their behalf and they should therefore be taking the lead on compliance with the new obligations. Trustees may wish to ask their investment managers to confirm this.

10. Government response to the Taylor Review of Modern Working Practices

The Government published its response to the Taylor Review last month, setting out proposals to improve the rights of workers and awareness of those rights, along with four consultation papers on: employment status, measures to increase transparency in the UK labour market, agency workers and the enforcement of employment rights.

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8 Regulation 2016/1011.

In terms of pensions-specific proposals, it acknowledged the recommendation to make auto-enrolment available to the self-employed, but confirmed that it does not believe it will work (because there is no third party employer).

Many of the other proposals require further consultation before a decision can be made as to the best way to respond. Please see our March edition of UK: Employment Update for more details.

11. Government publishes interim response on social investment

The DWP has published its interim response to the Law Commission's recommendations regarding pension funds and social investment. In its response published at the end of last year, the DWP says it is minded to make most of the recommended changes, subject to consultation.

In particular, amendments which would require trustees to state in their Statement of Investment Principles how they have evaluated risks to an investment in the long term, including risks relating to sustainability arising from corporate governance or from environmental or social impact and how they have considered and responded to members' ethical and other concerns. In addition, amendments which would require trustees to state in their Statement of Investment Principles the trustees' policy (if any) on stewardship.

The DWP more recently confirmed that it will be publishing a full response to the Law Commission's report by June 2018.

12. DWP publishes auto-enrolment review 2017

The DWP has carried out a review of auto-enrolment to consider how to build on its success for the future and its paper published at the end of last year sets out a number of proposals to improve the regime.

Problem	Proposal
People are not saving enough: *reports indicate that the State Pension, supplemented by auto-enrolment contributions of 8% of relevant earnings would only deliver around 50% of the savings needed to provide an adequate retirement income.*	Reduce the lower age limit from age 22 to age 18 and change the framework to remove the lower limit qualifying earnings band so that contributions are calculated from the first pound earned. The upper earnings limit would be retained, and the earnings trigger of £10,000 would be retained, but those earning below £10,000 who opt in would receive contributions based on all their earnings.
A large proportion of the self-employed population has significant gaps in pension saving	No specific proposal, but the Government is going to look at how best to help the self-employed.
People are not engaged with retirement saving	No specific proposal, but the Government is going to look at how best to build a sense of personal ownership of workplace pension saving, with a particular focus on member communications.

Timing: The ambition is to consult on these proposals in 2018 and 2019, with a view to changes being made in the mid 2020s.

More recently the DWP announced the auto-enrolment earnings thresholds for 2018/19:

- Earnings trigger of £10,000 to be maintained
- Lower limit qualifying earnings band to be increased from £5,876 to £6,032

- Upper limit qualifying earnings band to be increased from £43,000 to £46,350

13. Other pensions news in brief

- **Finance Act 2018**

  Provisions enacted in the Finance Act 2018 will extend the circumstances in which HMRC may refuse to register a pension scheme (or de-register an existing registered pension scheme) to include cases where the scheme's sponsoring employer is a dormant company.

- **Deadline for protected rights resolutions 5 April**

  The trustees of occupational DC schemes which were formerly contracted-out on the protected rights basis have until 5 April to make use of the statutory modification power to remove any rules making special provision for protected rights.

- **TPAS dispute resolution function moving to Ombudsman from April 2018**

  With effect from 1 April, all pensions complaints will be dealt with by the Ombudsman. TPAS will continue to focus on providing pension information and guidance, and will become an integral part of the new Single Financial Guidance Body. It is reported that pension schemes and providers will be given information to enable them to make the necessary changes to their signposting.

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