UK: PENSIONS UPDATE - MARCH 2019

1. PENSIONS REGULATOR ANNOUNCES CESSATION OF ANTI-AVOIDANCE INVESTIGATION INTO JOHNSTON PRESS

Today, the Pensions Regulator published a section 89 report in which it confirms it has found no evidence supporting the use of either a Financial Support Direction or a Contribution Notice and has therefore closed its anti-avoidance investigation into the Johnston Press Pension Plan.

The case

The sponsoring employers of the Johnston Press Pension Plan and most of the rest of the Johnston Press Group went into administration and substantially all the business and assets were then sold to a company owned by the Group's bondholders under a pre-pack arrangement, which completed in mid-November 2018. (Prior to this, the employers had approached the Regulator and the Pension Protection Fund to explore the possibility of a regulated apportionment arrangement, but this was not progressed.)

The Regulator opened an anti-avoidance investigation to establish whether there were any activities in respect of the pre-pack and the preceding events that would cause it to use its anti-avoidance powers. The Regulator has concluded there is no such evidence to support an exercise of its powers at this stage. (The report does note, however, that if any new and relevant evidence is uncovered, this may lead to a reopening of the investigation).

What can we learn from the Regulator's report?

The Regulator says its enquiries focused on a number of issues, but there was no evidence to suggest that insolvency was avoidable, nor that the administration was planned to circumvent payment of a deficit reduction contribution (**DRC**) (a DRC of c£885,000 had been due to be paid to the scheme under the Schedule of Contributions very shortly after the transaction was completed), nor that there were any acts pre-dating the administration worthy of further investigation.

This latest report may suggest that deliberately timing an administration to avoid paying DRCs and/or failing to properly consider viable alternatives to administration could be triggers for Regulator action, while making a bona fide decision to put a business into administration in light of its performance and in the absence of any viable alternatives will not. However, it is important to bear in mind that such cases are fact-specific, and the Regulator's

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decision will have been based on the individual facts and circumstances (not all of which are detailed in the report). It is therefore difficult to draw broad conclusions or general principles from such a case.

2. PENSIONS REGULATOR PUBLISHES ANNUAL DB FUNDING STATEMENT

On 5 March, the Pensions Regulator published its 2019 funding statement, setting out its expectations for how defined benefit (**DB**) pension schemes should approach forthcoming valuations.

Key points of note include the following:

- ***Dividends/other shareholder distributions***: the Regulator remains concerned about the disparity between dividend growth and stable DRCs, commenting on the risk of long recovery plans where payments to shareholders are excessive relative to DRCs. The Regulator is also concerned about other forms of covenant leakage which may be occurring in preference of higher DRCs and shorter recovery plans. The Regulator's key principles on this are that:
  - where dividends and other shareholder distributions exceed DRCs, the Regulator expects a strong funding target and recovery plans to be relatively short
  - if the employer covenant is tending to weak or weak, the Regulator expects DRCs to be larger than shareholder distributions unless the recovery plan is short and the funding target is strong.
  - if the employer is weak and unable to support the scheme, the Regulator expects the payment of shareholder distributions to have ceased.
- ***Long-term funding targets***: whilst acknowledging that many schemes already have long-term funding objectives, the Regulator expects trustees to set a long-term funding target with a journey plan of how to achieve this, noting the Government's intent to make this a legal requirement for schemes at some point in the future.
- ***Focus on scheme maturity***: the Regulator expects scheme maturity to form a significant factor in setting funding and investment strategies in future, given that the majority of schemes are closed to new members.
- ***Long recovery plans***: the Regulator will be looking at both the scheme maturity and employer covenant in considering what it is an acceptable recovery plan length.
- ***Late valuations***: the Regulator emphasises that, whilst it expects all trustees to start their valuation process in good time and to follow a plan designed to reach agreement within the 15-month statutory timescale, its preference is for a valuation which reflects the best outcome for the scheme, rather than one agreed under pressure to meet the deadline.
- ***DB funding Code***: as announced previously, the Regulator is intending to review and update its DB funding Code of Practice. The Regulator plans to consult this Summer on various options for a revised funding framework under the new Code, followed by a consultation on the revised Code itself.
- ***Brexit***: the Regulator reminds trustees and employers of the **statement** it published on 24 January 2019 outlining the Brexit-related steps they can initiate and notes that it will continue to monitor the situation and issue further guidance if needed.

Whilst the statement sets out the Regulator's general expectations, there is an acknowledgement that individual scheme circumstances might mean an alternative approach is appropriate. Where trustees do take an alternative approach, they are advised to consider obtaining evidence and justification for doing so.

The Regulator's new regulatory approach

The Regulator says it will be contacting many more schemes before their valuations are submitted as part of its new regulatory approach in order to identify potential risks which could impact on members. It will focus on schemes where it has concerns around the equitable treatment of members (i.e. an expectation that the scheme should be treated equitably when compared with other stakeholders) and unacceptably long recovery plans.

3. CMA CONSULTS ON DRAFT RULES TO IMPLEMENT INVESTMENT CONSULTANCY AND FIDUCIARY MANAGEMENT REFORMS

As we reported in the **December edition** of the UK: Pensions Update, the Competition & Markets Authority (**CMA**) recently announced a range of reforms to the investment consultancy and fiduciary management sector after finding competition problems, particularly in the pensions arena.

The CMA has now published for consultation a draft Order[1] designed to implement these reforms. In particular, the draft Order proposes:

- a prohibition on pension scheme trustees from receiving (and fiduciary management providers from providing) "Fiduciary Management Services", unless the trustees have carried out a "Competitive Tender Process" before appointing the provider, where the fiduciary management agreement (either alone, or, together with other fiduciary management agreements relating to the scheme) would cover 20% or more of the scheme's assets.
- where trustees have already appointed one or more fiduciary management providers covering 20% or more of the scheme's assets without having conducted a Competitive Tender Process, a requirement to conduct such process within five years from the date of the first appointment of a fiduciary management provider. A two-year grace period is to be provided to ensure that all schemes whose mandate already exceeds the five-year period, or which are approaching it, have time to organise a Competitive Tender Process (giving them two years from the date on which the Order is made to complete the process).
- a prohibition on trustees from receiving investment consultancy services unless they have set "Strategic Objectives" for their investment consultancy provider. (The expectation is that these objectives would be closely linked to the scheme's investment objectives in most cases and that they will be reviewed at least every three years and after any significant change to the scheme's investment strategy.) (*It is not clear from the draft Order or consultation documents exactly how this is intended to work given that pension scheme trustees may well not have the expertise themselves to set these "Strategic Objectives". This may well be a point which is picked-up during the consultation. The CMA also indicates that there will be guidance published to assist trustees and providers in complying with the Order (once this has been finalised), which may shed more light on exactly how this prohibition would operate in practice*.)
- new requirements on trustees, fiduciary management providers and investment consultancy providers to submit various compliance statements to the CMA.
- a new requirement for firms which provide both fiduciary management and investment consultancy services to clearly separate advice from marketing materials.
- various measures intended to provide trustees with more information on the fees and performance of fiduciary managers and investment consultants

Note that certain pension scheme trustees are intended to be exempt from the requirements of the Order (in particular, trustees of public service pension schemes and certain master trusts).

"**Fiduciary Management Services**" is defined in the draft Order as, broadly, the provision to trustees of both advice on investment strategy / investments and the making of investment decisions on the trustees' behalf on an ongoing basis pursuant to a delegation of authority by the trustees.

"**Competitive Tender Process**" is defined in the draft Order as a process by which pension scheme trustees have invited and used their best endeavours to obtain bids for the provision of Fiduciary Management Services from three or more unrelated providers and have evaluated the bids received. ('Unrelated' for these purposes means independent of each other and thereby in a position to compete).

"**Strategic Objectives**" is defined in the draft Order as defined objectives for the investment consultancy provider's investment advice, to meet the trustee's investment strategy.

1 The draft Investment Consultancy and Fiduciary Management Market Investigation Order 2019.

Timing

The CMA invites comments on the draft Order (and an accompanying draft explanatory note) by 13 March 2019. Implementation of the new requirements is then expected to begin later this year (with the main operative provisions due to come into force six months after the final Order is made).

Consequences of breach

In terms of possible consequences of not complying with the new requirements (once the Order comes into force), the CMA has power to give directions to ensure compliance and to enforce compliance by civil proceedings (for an injunction or for any other appropriate relief/remedy). The CMA also notes that any person who sustains loss or damage as a result of a breach of the Order may also bring an action before the court against those in breach.

4. PPF FACES CHALLENGE TO APPROACH FOR UPLIFTING COMPENSATION FOLLOWING ECJ RULING

As we reported in previous editions of the UK: Pensions Update, the Pension Protection Fund (**PPF**) has issued various statements setting out the steps it is taking to implement the European Court of Justice (**ECJ**) ruling in the case of ***Hampshire***[2] (which confirmed that where application of the PPF compensation rules results in an individual receiving less than 50% of their accrued entitlement, this is incompatible with the EU Insolvency Directive).

In previous statements, the PPF had confirmed it would adopt a phased approach, focusing first on pensioners subject to the long-service cap (the group most likely to be substantially affected), following by pensioners subject to the standard compensation cap and then considering all other cases.

The PPF had also confirmed it was developing a process to uplift compensation payments which would involve a comparison of the value of the PPF compensation due to an individual at their scheme's PPF assessment date with the value of the benefits the member would have expected to receive from their scheme at the same date. Where the value of the PPF compensation is less than 50% of the value of the scheme benefits, the PPF then intends to make a one-off increase to the headline level of compensation to bring it up to the 50% level.

On 14 February, the PPF issued a further update disclosing that court proceedings have been issued seeking to challenge, amongst other things, the PPF's intended approach (described above) for calculating any increases due to members as a result of the ruling. Specific details of the court proceedings have not been made public, but the PPF has confirmed that, in the meantime, it intends to proceed with its original approach as planned.

5. DWP CONSULTS ON PROPOSALS TO ENCOURAGE WIDER DC INVESTMENT AND DC CONSOLIDATION

At the beginning of February, the Department for Work and Pensions (**DWP**) launched a new consultation[3] which sets out proposals to encourage occupational defined contribution (**DC**) schemes to consider investing in illiquid assets; as well as proposals to encourage consolidation amongst smaller DC schemes. The consultation closes on 1 April 2019.

Encouraging wider investment

The consultation proposes a new requirement for "larger" DC schemes (those with assets above a certain level (of perhaps £250m or £1bn), or alternatively, assessing by reference to membership numbers and applying the requirement to only those schemes with membership numbers above a certain level)[4] to document and publish their policy in relation to "illiquid investments", and report annually on their approximate percentage allocation to this kind of investment in their Statement of Investment Principles (**SIP**) (and potentially, in the Default SIP). **Note the DWP is not proposing a requirement to *invest* in**

"**illiquid investments**" would need to be defined, but the consultation paper notes that, in broad terms, this means assets which are traded off-exchange or are otherwise less readily tradeable.

E.g. direct property investment, investment in infrastructure projects, private equity, equity or debt issued by very small listed firms and venture capital.

2 *Grenville Hampshire v The Board of the Pension Protection Fund [2018] (Case C-17/17).*

3 *"Investment Innovation and Future Consolidation: A Consultation on the Consideration of Illiquid Assets and the Development of Scale in Occupational Defined Contribution schemes".*

4 For a scheme which has both DB and DC sections, the consultation indicates that these thresholds would apply to the DC section/assets only.

illiquid investments, but a requirement for trustees to have *considered* illiquid investments in formulating their investment strategy.

Encouraging DC consolidation

The consultation also discusses various options for encouraging consolidation amongst "smaller" DC schemes (those with assets of below £10m / below 1,000 members).

It suggests one option would be to extend the 'value for members' assessment which schemes are already required to produce as part of their Chair's statement. This could include an assessment of whether it might be in scheme members' interests to be transferred into another scheme (such as an authorised master trust). The consultation notes that the assessment would need to be holistic i.e. not restricted to comparing charges/costs and investment strategies alone (although these would be significant considerations). Other considerations, such as the quality of governance and administration would also be legitimate areas of comparison.

The proposal is for such an assessment to be conducted triennially and after any significant change in the size or demographic profile of the scheme.

Additional method of assessment for compliance with the 0.75% charges cap

Finally, the consultation also proposes to introduce an additional method of assessment for compliance with the DC charges cap which applies in default funds of schemes used for auto-enrolment (on the basis that the current method could act as a barrier to illiquid investment).

6. POLITICAL AGREEMENT REACHED ON EMIR REFIT REGULATION WOULD FURTHER EXTEND PENSIONS CLEARING EXEMPTION

As we reported in the **September edition** of the UK: Pensions Update, certain pension schemes used to benefit from a transitional exemption in the European Market Infrastructure Regulation (**EMIR**), meaning they did not have to comply with the obligation for over-the-counter (**OTC**) derivatives to be cleared.

The exemption was extended twice and expired on 17 August 2018 as it was not possible to further extend the exemption under EMIR.

Despite not being officially extended, the European Securities and Markets Authority (**ESMA**) last year issued a statement confirming an intention to extend the exemption for a further (temporary) period, although this has resulted in a gap during which pension schemes are not technically covered by the exemption (but both ESMA and the Financial Conduct Authority (**FCA**) issued helpful statements recognising this difficulty for schemes and the FCA confirmed it would not be taking action during the gap period).

Following this, on 5 February, the Council of the EU published a press release announcing that preliminary agreement has been reached on the proposal for a Regulation to amend EMIR (the 'EMIR Refit Regulation'). One of the elements of the text which has been agreed is a two-year extension (extendable, twice, by an additional year) of the temporary clearing exemption for pension scheme arrangements. The next step is for the text to be submitted to the EU ambassadors for endorsement.

7. BREXIT PENSION REGULATIONS MADE

The final version of *The Occupational and Personal Pension Schemes (Amendment etc.) (EU Exit) Regulations 2019* were made on 5 February 2019 and will come into force on 29 March 2019 if the UK leaves the EU without a deal. The purpose of the regulations is to make minor and technical changes to UK pensions legislation to ensure retained EU law continues to operate effectively.

The changes are part of the Government's wider contingency planning in the event the UK leaves the EU without a withdrawal agreement in place.

Please see the **December edition** of the UK: Pensions Update for more details on the changes which will be made by these regulations.

8. ECONOMIC AFFAIRS COMMITTEE REPORT CHALLENGES USE OF RPI

The Economic Affairs Committee published a report in January on "Measuring Inflation" which focuses on the future of the Retail Prices Index (**RPI**) and its use by the Government. Publication of the report has already resulted in a drop to the RPI, which (in addition to the findings of the report and the changes this could provoke, as discussed below) is likely to have an impact on pension scheme valuation discussions.

The report

In its report, the Committee finds that the UK Statistics Authority is at risk of being in breach of its statutory duties on the publication of statistics, by refusing to correct an error that it 'openly admits' exists in the RPI. (This is a reference to an error made in 2010 when changes were made to the clothing price component of the RPI. Although both the Consumer Prices Index (**CPI**) and RPI were affected, it is estimated to have added 0.3% per annum to the overall gap between the RPI and the CPI because of the 'formula effect' – the difference in the annual rate of change in the RPI compared to the CPI due to the way in which price averages are calculated.)

The Committee is calling for the Authority to correct the error. It also recommends adopting a single measure of general inflation for official use going forwards to prevent 'index-shopping' by the Government – where indices are chosen because of their impact on public finances rather than their merits as measures of inflation (with benefits, tax thresholds and public sector and state pensions having switched from being uprated by the higher RPI to the lower CPI in 2011, whereas e.g. annual rail fare increases and interest on student loans continue to be linked to the higher RPI). The Committee urges the Authority and the Government to agree on this single measure within the next five years.

The report has brought the debate about the RPI back into the spotlight and could be a driver for imminent change. If changes are made to the RPI (to narrow the gap between the RPI and the CPI), this would have implications both for the valuation of pension scheme assets and liabilities and investment strategies. It is possible this could also re-open the debate in due course on whether RPI can be said to have been materially altered, replaced, etc. for the purposes of scheme rules.

9. FCA PUBLISHES REVISED RULES FOLLOWING RETIREMENT OUTCOMES REVIEW

The FCA has published a policy statement setting out the response to its consultation on proposed changes to its rules following the FCA's retirement outcomes review, together with the final rules and guidance.

The FCA had consulted on proposals covering 'wake-up' packs (which are sent to consumers before they decide how to access their pension savings), information provided to consumers about annuities and eligibility for enhanced annuities and changes to make the cost of drawdown products clearer and more comparable.

In its policy statement, the FCA confirms it is proceeding largely on the basis on which it consulted, subject to a few refinements.

The new rules

Rules	Timing
'Wake-up' packs, retirement risk warnings and reminder changes • Changes to the information that firms must give in the wake-up pack and the frequency of its delivery. • Amendments to the requirements for the reminder that firms send consumers after receipt of the wake-up pack to improve uptake of pensions guidance. • Requirement for firms to provide retirement risk warnings alongside the wake-up pack.	Come into force on 1 November 2019
Introduction of an annuity information prompt	Come into force on 1 November 2019

Rules	Timing
Changes to improve the effectiveness of the information prompt for consumers potentially eligible to purchase enhanced annuities, enabling more consumers to secure a potentially higher income from their annuity.	
Changes to make the cost of drawdown products clearer and more comparable	Come into force on 6 April 2020

Further consultation

At the same time, the FCA has published a separate consultation which proposes to introduce a requirement for firms offering drawdown to provide a range of default investment solutions ("investment pathways") to help consumers select investments that meet their broad objectives for their fund in drawdown, along with certain other changes.

This consultation closes on 5 April 2019.

10. GOVERNMENT PROPOSES TO EXTEND FAIR DEAL TO THE LGPS

The Government has launched a consultation on proposals to strengthen the pensions protections that apply when an employee of a Local Government Pension Scheme (**LGPS**) employer is compulsorily transferred to an independent service provider.

The changes are designed to bring the LGPS in line with the Government's October 2013 Fair Deal guidance (which covers central government departments and their agencies, the NHS, schools that are not local authority maintained (such as academies) and any other parts of the public sector under the control of Ministers where staff are eligible to be members of a public service pension scheme).

The changes

The consultation proposes a number of amendments to the regulations governing the LGPS which would, in most cases, give transferred employees a continued right to membership of the LGPS. (Currently, employers with staff who have been transferred from the LGPS can either retain access to the LGPS or they can offer staff entry into a private pension scheme certified by an actuary as being "broadly comparable" to the LGPS). In addition, as long as the employees remain wholly or mainly employed on the delivery of the service or function transferred, they will continue to retain that protection even if the service is subsequently sub-contracted or transferred out again.

Transitional measures

The intention is to ensure that employees who have already been transferred-out under the current regime (which is governed by the Best Value Staff Transfers (Pensions Direction) 2007 and the Welsh Authorities Staff Transfers (Pensions) Direction 2012) gain the improved protections the next time a contract is re-tendered. In addition, those transferred employees who were entitled to pension protection under the 2007 Direction or the 2012 Direction and were given access to a "broadly comparable" scheme will have a right to transfer their benefits from that scheme to the LGPS.

The consultation closes on 4 April 2019.

11. DWP CONSULTS ON CHANGES TO SERVICES OF THE PENSIONS OMBUDSMAN

The DWP has been consulting on several changes to the functions and jurisdiction of the Pensions Ombudsman.

The consultation, which launched at the end of last year, proposes to:

- make new provision for dispute resolution by the Ombudsman, by introducing a new function for the early resolution of disputes before a formal determination. Complaints dealt with via this service would not be required to go through the scheme's internal dispute resolution procedure first;
- allow an employer to make a complaint or refer a dispute to the Ombudsman on its own behalf, where e.g. the employer chooses a group personal pension arrangement as the vehicle for pension provision for their employees; and

- make provision in relation to associated signposting provisions.

The consultation closed on 18 January and a response is currently awaited.

Many of the proposals would require primary legislation and the Government indicates that it will seek to legislate in due course when parliamentary time allows.

12. PPF PUBLISHES GUIDANCE ON APPROACH TO EMPLOYER RESTRUCTURINGS

The PPF has published revised guidance covering its approach to employer restructurings, which seems to have been prompted by a number of high-profile restructuring cases which have recently made the headlines.

Purpose of the guidance

Occasionally, an employer with a pension scheme in deficit faces insolvency and will propose a restructuring package to allow them to continue trading, while the PPF takes on the scheme. As such arrangements can sometimes be controversial, the PPF says it feels it is important to provide some more information about its approach to such situations.

The guidance summarises why the PPF might enter into a restructuring agreement and the principles it uses to make its decisions. It is designed to assist employers, trustees and their advisors in formulating proposals and managing expectations of possible outcomes.

Restructuring principles

1.	Insolvency must be inevitable.
2.	The pension scheme will receive money (or in rare circumstances, assets) which are of a significantly higher value than it would have otherwise received via an employer insolvency.
3.	What is offered to the pension scheme in the restructuring is fair compared to what other creditors and stakeholders receive as part of the transaction.
4.	The PPF will seek at least 33% of the equity in the restructured company for the scheme (an 'anti-embarrassment' stake). Should the future stakeholders be entirely unconnected or involved with the company prior to the restructuring, it may agree a smaller percentage, but this will never be less than 10%.
5.	The PPF needs to make sure the scheme would not be better off if the Pensions Regulator had used its moral hazard powers to issue a contribution notice or financial support direction instead of agreeing to the restructuring.
6.	The PPF will consider the overall viability of the employer's restructuring proposal.
7.	The party seeking the restructuring must pay the costs incurred by both the PPF and the trustees in delivering the restructuring.

The PPF says it applies these principles in all situations.

13. NEW SINGLE FINANCIAL GUIDANCE BODY IS OFFICIALLY NAMED

The new single financial guidance body, which replaced The Pensions Advisory Service, Money Advice Service and Pension Wise and was established at the end of last year, started delivering its functions on 1 January 2019.

New Regulations[5] were laid at the beginning of this month and will come into force on 6 April 2019, naming the body the "Money and Pensions Service".

5 *The Financial Guidance and Claims Act 2018 (Naming and Consequential Amendments) Regulations 2019*

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