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UK: PENSIONS UPDATE – SEPTEMBER 2020

1. DC VALUE FOR MEMBERS REVIEW – NEXT STEPS

Key issues

1. DC value for members review – next steps
2. DWP call for evidence on DC charge cap
3. DWP launches climate risk consultation
4. HM Treasury call for evidence on the administration of pensions tax relief
5. HMRC publishes GMP equalisation guidance on lump sum payments
6. Schrems II – CJEU rules EU-US Privacy Shield invalid
7. Safeway equalisation case returns to the Court of Appeal
8. TPR updates COVID-19 reporting and enforcement guidance
9. Expanded trust registration regulations laid before Parliament
10. Consultation on the departure from retained EU case law by UK courts and tribunals
11. On the horizon

On 11 September 2020, the Department for Work and Pensions (**DWP**) published its consultation "*Improving outcomes for members of defined contribution pension schemes*", which combines its response to the February 2019 consultation "*Investment Innovation and Future Consolidation*" together with a fresh consultation on changes to regulations and statutory guidance designed to strengthen what defined contribution (**DC**) scheme trustees must consider when assessing their scheme's 'value for members' and to encourage DC consolidation. The consultation closes on 30 October 2020 and the current intention is that the proposals would be brought into force on 5 October 2021.

As reported in our UK: Pensions Update – March 2019, the February 2019 consultation set out proposals to encourage DC schemes to consider investing in "illiquid assets" and to encourage consolidation of smaller DC schemes. This included proposals to extend the scope of the current 'value for members' assessment which relevant schemes (broadly, schemes that provide DC benefits other than just AVCs) are already required to produce as part of their Chair's Statement to include an assessment of whether it might be in member interests to wind-up and transfer to another scheme.

The new consultation makes the following key proposals:

Encouraging wider DC investment

In order to encourage wider DC investment, the DWP is proposing to change the way that compliance with the charges cap on default funds is measured. Namely, to better enable schemes to pay performance fees and to exclude costs of holding 'physical assets' (e.g. land, buildings, vehicles etc). Note that contemporaneously, the DWP is reviewing the level of the 0.75% charges cap on default funds as well as considering the permitted combination charging structures and the treatment of transaction costs (see paragraph 2 below).

Consolidation

The consultation proposes that relevant schemes with assets below £100 million must annually assess and report on how their scheme presents value for members taking into account: (i) costs and charges; (ii) investment returns and (iii) various elements of governance and administration. It's proposed that where value for members isn't demonstrated under the new assessment, trustees should take immediate steps to wind up the scheme and consolidate members into a larger scheme, unless in exceptional circumstances they can improve both rapidly and cost effectively – this is a rather stronger message than the more 'focus on improvement' tone of the previous consultation.

It is also proposed that all relevant schemes regardless of size must:

- report on the return on investments of default and member selected funds (such information to be made publicly available free of charge on a website); and
- report to the Pensions Regulator (**TPR**) the total amount of assets held in the scheme in the annual scheme return.

Other

Various other changes are proposed including a requirement to require "with profits" schemes to produce a default statement of investment principles (**SIP**) and excluding wholly insured schemes from some of the SIP disclosure requirements.

2. DWP CALL FOR EVIDENCE ON DC CHARGE CAP

On 25 June 2020, the DWP published a call for evidence seeking views on the effectiveness of costs, charges and transparency measures in protecting pension member outcomes. The call for evidence, together with a Pension Charges Survey, will inform the Government's review of the default fund charge cap (**Cap**).

The Cap, which was introduced in 2015, applies solely to the default fund of DC auto-enrolment schemes (subject to certain exceptions) and its purpose is to protect members from high and unfair charges. The cap was set at 0.75% and, save with respect to some limited exceptions (e.g. transaction costs), it applies to all charges associated with scheme and investment administration that are borne by the member.

The DWP is seeking feedback on options for revising the Cap including: whether the level of the charge cap should change; the extent to which transaction costs and other costs associated with life assurance products should be included in the cap; fees structures and in particular, how members subject to charging structures which include a flat fee element are protected from excessive charges; and options for assessing existing take-up, and widening the use, of standardised cost disclosure templates when calculating and evaluating pension charges. The upcoming Charges Survey will gather evidence from providers on current costs and their drivers, in order to capture the full range of charges that are being applied to DC schemes.

> "*There is mixed evidence that higher cost providers consistently deliver higher performance, net of costs, beyond what could be achieved by passive indexing within a particular asset class.*" - DWP

While the DWP recognises that in practice many providers were already comfortably below the cap prior to its introduction (although it notes that some do continue to charge near to or at the Cap), it is concerned that while a decrease might further improve value for members, it could also limit schemes' ability to diversify their portfolios.

The call for evidence ran until 20 August 2020 and proposals are anticipated for later this year.

3. DWP LAUNCHES CLIMATE RISK CONSULTATION

The DWP launched its climate change consultation on pension schemes' governance and reporting on climate change on 26 August 2020 and it will close on 7 October 2020. The DWP is proposing to introduce new regulations which will require trustees to assess and report on the financial risks of climate change within their investment portfolios. It is proposed that the new requirements would be phased in – with only the very largest schemes (those with £5bn or more of assets), authorised master trusts and CDC schemes becoming subject to the new requirements first (needing to comply with the governance requirements from October 2021 and report on these by the end of 2022). Following this, schemes with £1bn or more of assets would fall within scope in 2023. A further consultation in 2024, to determine whether to extend the requirements to all occupational schemes, is then envisaged.

Note that the proposals do not attempt to direct trustees in their investment decisions (such discretion will remain with trustees) and in particular there is no change in the legal requirements regarding trustees' investment duties

(trustees should remain mindful that climate change is only a relevant factor for trustees to the extent it positively affects financial performance/risk).

Who is in scope?	Both defined benefit (**DB**) and DC schemes would fall within scope. DB consolidators (the so-called 'superfunds') would also fall within scope if they meet the net asset thresholds (which is expected to be the case over time).
What requirements have been proposed?	• To embed the recommendations of the international industry-led Taskforce on Climate-related Financial Disclosures ("TCFD") into pensions law by introducing regulations that require schemes to put in place effective governance, strategy, risk management and accompanying metrics and targets for the assessment and management of climate risks/opportunities and to report on these in line with the TCFD's recommendations. • Requiring schemes to publish their report on a website and to notify members of this via their annual benefit statement. • Requiring schemes to provide TPR with the website address of where they have published their report via the annual scheme return form. Introducing mandatory penalties issued by TPR for any complete failure to publish a Taskforce report. Other penalties would be subject to TPR's discretion.
Will there be guidance?	Statutory guidance (on a "comply or explain" basis) would be published which would set out steps for trustees to meet and report on the TCFD requirements. In addition, as reported in our UK: Pensions Update – March 2020, non-statutory guidance is also expected to be published by the Pensions Climate Risk Industry Group to assist trustees towards the end of 2020.
What is the timescale for implementation?	The Government intends to consult on draft regulations in late 2020/early 2021, before they are laid next year. (Note that these regulations would be made under powers to be introduced in the Pension Schemes Bill 2019-21, which itself has not yet been passed).

4. HM TREASURY CALL FOR EVIDENCE ON THE ADMINISTRATION OF PENSIONS TAX RELIEF

HM Treasury has published a call for evidence on pensions tax relief. The focus of the consultation is on potential changes to the two main methods of administering tax relief – net pay and relief at source (note that it does not look at more fundamental changes to reform the system of pensions tax relief more generally).

Net pay arrangements: *the employee's pension contributions are deducted from the employee's employment taxable income before operating PAYE (the employee then generally gets tax relief at their marginal rate of income without needing to make an additional claim).*

Relief at source: *the employee's pension contributions are made from post-tax income (and the scheme administrator claims a repayment of basic rate tax from HMRC with higher rate tax payers able to claim back higher rate tax through Self-Assessment).*

Broadly, one of the concerns that has arisen relates to the differing tax treatment of low earners. Where an individual's marginal rate of income tax is below the basic rate, they effectively receive a government 'top-up' if they make pension contributions into a relief at source scheme. This is because they still receive a payment into their scheme equivalent to basic rate tax relief. In contrast, lower earners in a net pay scheme do not receive this additional top-up. Additionally, there is a timing delay in the investment of the tax relieved amount where relief at

source is used, given the tax relief claim is made one year after the end of the tax year (although pension schemes can make interim claims more regularly). For higher rate tax payers, there will also be a delay in claiming back the additional tax relief via their Self-Assessment tax return (but while this is touched upon it is not a focus of the consultation).

The consultation outlines four proposals for addressing the inequalities:

1.	Paying a bonus to lower earners in a net pay scheme to put them in the same position as relief at source scheme members.
2.	Applying a standalone charge on relief at source schemes to recover the top-up.
3.	Requiring employers to operate two schemes – one net pay and one relief at source and switch employee contributions between schemes depending on whether their earnings would take them over their personal allowance for that pay period.
4.	Mandating the use of relief at source for defined contribution schemes.

None of the above meet all of the government's principles of change and so alternative suggestions are being sought - the third proposal in particular appears to be unfeasible in practice. The consultation closes on 13 October 2020.

5. HMRC PUBLISHES GMP EQUALISATION GUIDANCE ON LUMP SUM PAYMENTS

On 16 July 2020, HMRC issued some further guidance on GMP equalisation to address some of the outstanding questions on the tax issues in respect of lump sums previously paid and the payment of future lump sums (i.e. top-ups) that were left open under its previous guidance (see UK: Pensions Update – March 2020 for further details).

However, the further guidance still does not cover GMP equalisation through conversion, which may well be the preferred method of equalisation for most schemes. In this regard HMRC says it is "unable" to provide supplemental guidance on conversion, as more detailed work needs to be done on the wider issues associated with that method. The guidance says that schemes using conversion should consider any tax implications in line with the existing legislation/HMRC guidance and seek advice as appropriate. It therefore seems unlikely that HMRC guidance on the pension tax implications of equalising GMPs through conversion will be forthcoming.

Status of previous lump sum payments

The guidance sets out HMRC's view regarding previous lump sum payments that must extinguish a member's rights in order to be an authorised payment (e.g. ill health lump sums and winding up lump sums) as being that the lump sum will not stop being an authorised payment if further entitlement to benefits/rights have been identified purely because of GMP equalisation. This is on the basis that the scheme administrator could not have reasonably known about the additional benefits/rights at the time of the payment and so at that time, the lump sum payment did so extinguish the member's entitlement.

Additionally, where the lump sum must be within a specific payment limit (e.g. small pot lump sums and winding up lump sums), as long as the previous lump sum payment did not exceed the relevant payment limit at the time of the payment, it will not stop being an authorised payment purely because further entitlement is later identified as a result of GMP equalisation.

However, unhelpfully HMRC says that the same analysis does not apply to trivial commutation lump sums (**TCLS**) because instead of a limit on the amount of the lump sum (currently £30,000), the limit is based on the value of the member's pension rights under all registered schemes on the 'nominated date'. If, as a result of equalising GMP rights, the value of the member's rights on the nominated date would have been more than the relevant limit, the original lump sum won't qualify as a TCLS and will be an unauthorised payment, unless the lump sum

could have met the payment conditions for another authorised payment. While unhelpful, query in practice how many members this will affect as many schemes limit pay out of small pensions to the small pot lump sum (currently £10,000).

Status of future lump sum payments

The guidance states that any future payment, including 'top-up' payments to previous lump sums, must satisfy the payment conditions in force at the time the payment is made. HMRC's view therefore is that this may mean that a top-up lump sum payment cannot be an authorised payment, or is another form of authorised payment. For example, the guidance highlights what while a pension commencement lump sum (**PCLS**) can be paid in stages, it must be paid within a certain period. If the member became entitled to their scheme pension more than 12 months ago, the scheme cannot now pay a further PCLS. However, note that this is only guidance as to HMRC's view and not a statement of the law, alternative interpretations of the requirements are possible and if in doubt trustees should seek professional advice on particular issues arising in relation to their schemes.

6. SCHREMS II – CJEU RULES EU–US PRIVACY SHIELD INVALID

On 16 July 2020, the Court of Justice for the European Union (**CJEU**) gave judgment in the *Schrems II* case[1] ruling that the previous decision of the European Commission regarding the adequacy of the protection provided by the EU-US privacy shield regime (very broadly, a framework arrangement under which the US complies with certain obligations to protect personal data/cooperate with the European data protection authorities, which allowed the transfer of personal data from the EU to the US without needing to take additional measures), is invalid. This was for several reasons, including that US law fails to limit access to transferred data by its national security agencies to what is strictly necessary and proportionate and only provides a limited ability for non-US citizens to challenge US agencies' processing of their data. This means that transfers of data to the US exclusively on the basis of the US privacy shield decision after 16 July 2020 are unlawful under the General Data Protection Regulation (**GDPR**) and data exporters will need to consider an alternative basis for justifying transfers of personal data to the US.

Pension schemes that currently transfer personal data to the US in reliance on the US privacy shield (which they may well do where the trustees transfer personal data to a scheme administrator who holds the data on servers in the US, or where one or more trustees are based in the US and routinely receive personal data), will have been impacted by the judgment. Such schemes will need to consider whether the use of the standard contractual clauses may be the most appropriate alternative for making transfers to the US in future (noting that there are other ways in which data transfers can be authorised under the GDPR, but these can be quite problematic in practice e.g. obtaining consent from each individual data subject).

Following the ruling, data protection authorities and regulators began to share their analyses of the impact of the decision on lawful transfer of personal data to the US. The European Data Protection Board issued a first set of guidance addressing the most urgent questions and the UK Information Commissioners Office (**ICO**) confirmed that this guidance still applies to UK controllers and processors. The ICO has also said that it "*will continue to apply a risk-based and proportionate approach in accordance with our Regulatory Action Policy*", and the UK government is reviewing the details of the judgment and working with the ICO and its international counterparts to make updated guidance available as soon as possible.

7. SAFEWAY EQUALISATION CASE RETURNS TO THE COURT OF APPEAL

On 2 July 2020, Safeway returned to the Court of Appeal following the CJEU's ruling on 7 October 2019 (see our UK: Pensions Update - January 2020). In summary, Safeway no longer sought to argue that normal pension ages (**NPAs**) had been equalised from the date of an announcement that was sent to members in December 1991, four and a half years prior to the date on which the scheme's governing documentation was amended by deed to formalise the equalisation of NPAs. As a result, there was no consideration given as to whether

[1] *Data Protection Commissioner v Facebook Ireland and Maximillian Schrems*, Case C-311/18

retrospective equalisation was necessary to prevent the financial balance of the Safeway scheme from being seriously undermined.

The Court of Appeal was therefore concerned with only one issue – the effect of the coming into force of section 62 of the Pensions Act 1995 (which imposed an equal treatment rule into occupational schemes and was intended to provide a domestic law framework for Article 119 (now Article 157 of the TFEU)) on 1 January 1996.

Safeway argued that the coming into force of section 62 on 1 January 1996 served to effectively equalise NPAs in the scheme from that date because it was an effective domestic law measure implementing Article 119 with respect to future pensionable service. Safeway argued that while the retrospective effect of the May 1996 deed (to December 1991) was prohibited by EU law (Article 119) this was only insofar as it related to the period between December 1991 and 31 December 1995 and therefore it remained effective to level down NPAs from 1 January 1996 because of section 62.

The Court of Appeal considered that the critical question was how to determine when "period 2" (the period between 17 May 1990 and the adoption by the scheme of measures reinstating equal treatment) ends so that "period 3" (the period after the scheme's adoption of measures reinstating equal treatment – at which point Article 119 does not preclude levelling down) may begin i.e. the date on which domestic law can apply.

The Court said that to be sufficient the measures must be immediate, full, unconditional and legally certain. The Court unanimously decided that section 62 met that criterion. As a result, the appeal was allowed and the Court held that NPAs within the Safeway scheme were equalised with effect from 1 January 1996.

8. TPR UPDATES COVID-19 GUIDANCE

On 16 September TPR updated some of its COVID-19 guidance - the 'reporting duties and enforcement activity guidance'.

Key points include the following:

Currently TPR provides an easement giving trustees/providers 150 days to report late payments of contributions (other than deficit reduction contributions (**DRCs**)) instead of the usual 90 days. This has been reviewed and from 1 January 2021 will be withdrawn i.e. will revert to the usual 90 days for this late reporting.
From 1 October, other types of enforcement will return to normal, including: • Enforcing requirements for schemes to submit audited accounts and SIP reviews; and • TPR will revert to reviewing chair's statements.
The guidance for trustees considering employer requests for a DRC reduction/suspension remains unchanged but is under review.

TPR's bank of COVID-19 guidance can be accessed here.

9. EXPANDED TRUST REGISTRATION REGULATIONS LAID BEFORE PARLIAMENT

On 15 September 2020, the Money Laundering and Terrorist Financing (Amendment) (EU Exit) Regulations 2020 were laid before Parliament (**Regulations**). The Regulations implement the remaining aspects of the requirements under the Fifth Money Laundering Directive (5MLD)[2] which had not been catered for by The Money Laundering and Terrorist Financing (Amendment) Regulations 2019, which were brought into force in December 2019 and which were the subject of a technical consultation by HMRC in January 2020.[3]

[2] (EU) 2018/843

[3] For further background see: UK: Pensions Update – January 2020 and UK: Pensions Update – March 2020.

In short, the Regulations exclude several types of trust from the expanded requirement for all express trusts to register with HMRC's Trust Registration Service (**TRS**) (i.e. irrespective of whether they incur a tax charge or not). The Regulations include exclusions for (i) a trust holding sums/assets of a pension scheme which is a registered pension scheme for the purposes of Part 4 of the PA 2004; and (ii) a trust of a life policy or retirement policy paying out only on the death, terminal or critical illness or permanent disablement of the person assured.

Note however that unregistered schemes which incur a tax consequence will still need to register with the TRS, for example where an unregistered death benefits scheme incurs a tax consequence (albeit this may be unlikely in practice). Detailed guidance to assist those required to register is expected in due course.

10. CONSULTATION ON THE DEPARTURE FROM RETAINED EU CASE LAW BY UK COURTS AND TRIBUNALS

On 2 July 2020 the Government launched its consultation on the departure from retained EU case law by UK Courts and tribunals (the consultation closed on 13 August 2020 and a response is awaited).

Currently, under the withdrawal arrangements[4], UK courts and tribunals cease to be bound by principles laid down by the CJEU or any decisions made by that court after 11pm on 31 December 2020 (i.e. the end of the "transition period") but broadly are bound by retained EU case law and general principals laid down prior to the end of the transition period. This is with the exception of the Supreme Court, High Court of Justiciary in Scotland, and other courts in some circumstances, each of which may be able to depart from retained EU case law in some circumstances.

The Government is consulting on whether the power to depart from retained EU case law should be extended to additional courts and tribunals (e.g. the Court of Appeal in England and Wales and equivalent courts in other UK jurisdictions), to reflect the changing circumstances which the UK's departure from the EU brings. In addition the Government is also seeking views on questions including whether the normal operation of precedent should apply, whether there should be a power to depart from retained domestic case law which relates to EU case law, and what the test for such departure should be.

The Government wishes to strike a balance between ensuring that the law should not become "*fossilised*" against the risk that too much latitude could cause "*forum shopping*" and create considerable legal uncertainty and "*a free for all*" where there would be a large financial incentive to re-litigate (e.g. in complex tax cases).

With respect to the latter, the government is proposing that the test applied by the UK Supreme Court when considering whether to depart from its own case law (broadly being "*when it appears right to do so*") should also apply to the relevant courts and tribunals permitted to depart from retained EU case law if such permission to depart is implemented following consultation.

Industry practitioners may be interested in the outcome of this consultation given that there are several areas of EU law which are still causing ongoing difficulties in a pensions context (e.g. GMP equalisation (including the lack of tax guidance), standard equalisation and PPF compensation) and it remains to be seen whether the consultation and its outcome will impact on developments in these areas.

11. ON THE HORIZON

Pension Schemes Bill and TPR Guidance

The Pension Schemes Bill 2019-21 (Bill) is currently progressing through Parliament but no date has yet been set for its second reading in the House of Commons. It may well be that once moving again, passage of the Bill is swift and it could be passed by the end of the year. However, the most concerning aspects of the Bill regarding the proposed new criminal offences remain unchanged currently, although TPR has openly confirmed its intention

[4] See section 6 of the European Union (Withdrawal) Act 2018 as amended by the European Union (Withdrawal Agreement) Act 2020.

to liaise with industry stakeholders (such as the Association of Pension Lawyers) on guidance regarding the criminal offences, and to consult on such guidance prior to the offences coming into law.

TPR's DB Funding Code

Consultation on TPR's revised DB funding code of practice closed on 2 September 2020. The consultation focussed on (i) TPR's proposed regulatory approach; (ii) the principles TPR thinks should underpin the new framework; and (iii) how such principles could be applied in practice to provide clearer guidelines. TPR's second consultation focussing on the draft code itself was planned for later in 2020 but is now expected around March 2021.

TPR updates timing for combining its Codes of Practice

TPR had planned to consult over the year 2019–20 on combining the content of its 15 current Codes of Practice to form a single, shorter code. However, it has now said that a formal consultation will be launched in late 2020 or early 2021.

PPF and DWP challenge Hughes ruling

The PPF has confirmed that both it and the DWP are appealing certain aspects of the Hughes[5] judgment. Broadly, Hughes upheld the PPF's general approach of a one-off actuarial calculation to calculating increases in compensation as a result of the Hampshire ruling, but it said that the PPF would also need to ensure that members and survivors each receive at least 50% on a cumulative basis of the actual value of the benefits their scheme would have provided, which the PPF is challenging. The DWP has also lodged an appeal against the ruling that the compensation cap is unlawful.

No information is currently available as to if and when the PPF can proceed to appeal. In the meantime the PPF will continue to make payments at the current level, withholding arrears and based on the existing compensation cap levels.

Supplementary Lloyds hearing

According to the Lloyds Bank Group members website there is to be another Lloyds hearing regarding GMP equalisation and revisiting past transfers-out as a result of the judge asking some further questions of the parties. This hearing is due to take place on 28-29 October 2020.

Court of Appeal hearing regarding the Prudential and Rothesay insurance business transfer

In August 2019, the High Court[6] refused to sanction an insurance business transfer scheme under Part 7 of the Financial Services and Markets Act 2000 that involved the transfer of a £12 billion portfolio of individual and bulk annuity policies from The Prudential Assurance Company Limited (**PAC**) to Rothesay. PAC and Rothesay lodged a joint application to appeal the High Court's decision in September 2019, which is now due to be heard on 27 October 2020 and is expected to last three days. If the appeal is successful, there will be a further hearing at the High Court to decide whether the proposed transfer should be approved.

5 [2020] EWHC 1598 (Admin)

6 *Re Prudential Assurance Company Ltd* [2019] EWHC 2245 (Ch)

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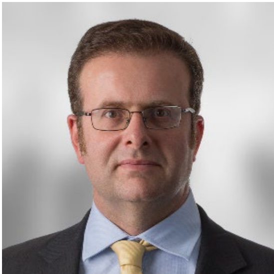

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