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Current issues

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Articles this month:

DB annual funding statement 2018

The Pensions Regulator has published its annual funding statement for the trustees and employers of defined benefit schemes, in particular those due to produce valuations with effective dates falling in the year to 21 September 2018.[1] The funding statement builds on the Department for Work and Pensions' White Paper from March 2018[2], setting out the Regulator's interpretation of what this means for pension schemes and business practices.

Risk Management & contingency plans

This year's statement sets out the main risks that trustees should be aware of based on the employer and scheme circumstances. The general message is that trustees should be securing funding for the scheme while the sponsoring business is still in a position to do so.

The statement includes a quick reference table highlighting what the Regulator sees as the main risks for schemes based on the scheme's and employer's situation and the actions it expects trustees to take.

The Regulator is clear that scheme size is not an excuse for poor risk management. Trustees of schemes of all sizes should work with their advisers to agree a practical way to manage risks in a way that is proportionate for their scheme.

Trustees are urged to consider the shorter-term risks to the security of member benefits while deficits are being funded, for example a downturn in the employer's business. If such an event would have a material effect on the scheme funding then trustees should aim to mitigate this risk by seeking additional cash in the short term or by taking other forms of security.

Emphasis is placed on the requirement for '*documented and workable*' contingency plans, and where possible, securing legally enforceable rights (e.g. against secured assets) for the scheme.

Fair treatment for schemes

As anticipated, in light of recent high-profile corporate failures, the Regulator is concerned about the growing disparity between dividend growth and deficit recovery payments (DRCs). It wants trustees to assess the effect that

[1] <www.thepensionsregulator.gov.uk/docs/db-annual-funding-statement-2018.pdf>.
[2] '*Protecting Defined benefit pension schemes*', <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/693655/protecting-defined-benefit-pension-schemes.pdf>.

dividend payments have on the employer's covenant and whether the scheme is being treated fairly with regard to what it needs to pay out promised benefits.

Trustees are encouraged to conduct an analysis of the relative amounts of dividends and DRCs and, where the balance seems unreasonable, they should '*negotiate robustly*' to ensure a fair deal for the pension scheme.

It is noted that distributions to shareholders are not the only consideration when determining if the scheme is being treated fairly. Other types of distributions such as loans to intra-group companies, and for smaller companies, the level of senior management pay should also be taken into account.

The Regulator has not commented on sectors where dividends are not directly applicable, such as charities. What fair treatment means in practice for these organisations will emerge from the Regulator's scheme by scheme intervention.

Transfer activity & scheme maturity

Trustees considering whether to allow for transfer values in their valuation assumptions should carefully think about their scheme's experience and likely future trends. Trustees should keep records of transfer activity and consider stress tests to make sure their scheme can withstand the volume of transfers out.

Since high levels of transfers out of the scheme will have the effect of increasing scheme maturity, if the scheme is underfunded and its assets are potentially volatile, the Regulator asks trustees to ensure that they understand how this will affect the ability of the scheme's remaining assets to produce returns sufficient to make up the funding level.

Advisers are expected to alert trustees of all schemes to the risks increasing scheme maturity poses to funding and investment. Trustees are, in turn, required to ensure that the scheme is being funded to a level where these risks are being managed.

Mortality assumptions

The Regulator makes it clear that the mortality assumptions used for the valuation should be appropriate to the scheme membership, in particular taking into account its socio-economic characteristics.

Late valuations

Although trustees are expected to conduct their valuation process in a way that leaves plenty of time for advice, analysis and negotiation with the employer, trustees are warned not to agree an inappropriate valuation and funding plan merely because the valuation deadline is looming. Where trustees have acted responsibly and taken all reasonable steps to finalise the valuation but there remains a legitimate reason why it cannot be finalised the Regulator may use its discretion not to impose a penalty for late completion.

Nothing in the Regulator's 2018 annual statement will come as a surprise to pensions industry experts. The content is entirely consistent with how we have seen the Regulator intervene in pension scheme valuations over the last year. This is a public display to restore confidence and encourage schemes to demonstrate best practice. The continued pressure to increase contributions and seek contingency plans that cover remaining risks is designed to give businesses nowhere to hide if pension scheme funding does not improve in the coming years. Given the pace at which pension schemes are maturing, it's hard to argue against the Regulator's direction of travel.

Whilst the Regulator's direction of travel may be hard to argue with, the force with which this is being put forward is debateable, particularly for stronger employers. The point of view that an employer being strong today does not mean it will be there forever is valid, but there are more effective solutions. The Regulator's guidance that trustees should pay more attention to the risk of sudden business demise and agree contingency plans to protect schemes provides a more balanced approach than simply pushing for higher contributions in all cases.

DWP tables ban on unsolicited direct marketing of pensions

The Department for Work and Pensions (DWP) proposes to give itself powers, in the Financial Guidance and Claims Bill, to prohibit unsolicited direct marketing (for example 'cold-calling') about pensions.[3] Another Government amendment would oblige the DWP to keep under review the position in relation to other consumer financial products, and allow it to ban unsolicited direct marketing of them, if appropriate.

The proposed clauses would replace cold-calling provisions inserted into the Bill by the House of Lords in October 2017. The Opposition amendment requires the new Single Financial Guidance Body (SFGB) that will be established by the Bill to advise the Government that a ban is desirable. However, the DWP and Her Majesty's Treasury have said that such a strategy would delay implementation until 2020, whereas they want to proceed more quickly.[4]

The Government cautions that there are 'difficult policy details' to be settled, such as the types of marketing that are to be prohibited, and those that should be allowed to continue (for example, where contact is made with an existing client). It thinks that broad regulation-making powers, including the ability to amend Acts of Parliament, are necessary, and will allow it to counteract new scams as they materialize.

It seems likely that the necessary secondary legislation will be in place by the end of June 2018. If it is not, the Government's amendments would oblige Secretary of State McVey to explain her failure to Parliament in July.

We look forward to seeing how the Government resolves those 'difficult policy details'. We cannot help thinking, however, that the true measure of the success of the venture will be how far it empowers members of the public to deal peremptorily with any strangers who call them out of the blue with offers to 'help' with their pensions.

Work & Pensions Committee report on freedom and choice

The House of Commons Work and Pensions Committee has published a final report on its inquiry into the 'freedom and choice' pension reforms.[5] It calls for the Government introduce an automatic drawdown pensions option and allow the National Employment Savings Trust (NEST) to offer decumulation products.[6]

The report calls for a package of measures to increase awareness and engagement among pension savers, and to provide a default method of decumulation to help the less-engaged at retirement. The main recommendations for the Government are as follows:

- by April 2019, require drawdown providers to have a 'default decumulation pathway' (the Committee would like to see a charge cap of 0.75 per cent for this default, in line with those that apply to automatic enrolment schemes);
- allow NEST to provide decumulation products, from April 2019;
- a single, publicly-hosted 'pensions dashboard' that covers State, defined contribution and defined benefit pensions, as opposed to the Government's current plans for multiple dashboards hosted by providers; and
- all pension providers should be required to issue one-page 'pensions passports', condensing essential information from retirement 'wake-up' packs, such as fund value, basic scheme information and next steps

[3] *House of Commons: Notices Of Amendments given up to and including Friday 20 April 2018* <https://publications.parliament.uk/pa/bills/cbill/2017-2019/0160/amend/financial_rm_rep_0420.1-7.html>.

[4] *Financial Guidance and Claims Bill: Supplementary Memorandum from the Department for Work and Pensions & HM Treasury to the Delegated Powers and Regulatory Reform Committee* <https://publications.parliament.uk/pa/bills/cbill/2017-2019/0131/PensionscoldcallingDPMfinalupdate.pdf>.

[5] <www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/news-parliament-2017/report-pension-freedoms-17-19/>.

[6] These are products that convert a pension fund into income, e.g. an annuity or drawdown fund.

into one side of A4 paper, as part of their pre-retirement member communications (a template for a best-practice passport should be produced by June 2018).

Some of the Committee's recommendations (such as those for the pensions dashboard) would require relatively recent policy decisions to be revisited, so it will be interesting to see to what extent the recommendations are adopted by the Government.

No six-year limitation period when overpayments recouped from pension

The High Court has confirmed that trustees' ability to recover overpayments by recouping them from pension instalments is not subject to a six-year statutory time limit.[7]

Facts

The trustees of the scheme resolved, in 1991, to begin to increase pensions in payment annually, as a way of reducing an actuarial surplus (the tax rules of the day required such action). The resolution was recorded in the minutes of a trustee meeting. Actual implementation of the policy began on 6 April 1992. The change was not formalized in the scheme's documentation.

The employer challenged the validity of the trustees' introduction of pension increases (on pre-6 April 1997 accrued rights) in 2011. They were suspended in 2013, pending resolution of the dispute.

Validity of the increases

The High Court ruled that the increases *were* validly introduced. The judge's reasoning is rather complicated, but the gist of it is as follows:

- although the trustees had not observed the formalities necessary to make the change in 1991, they *could* quite easily have so;
- the formalities required for amendments and benefit augmentations were somewhat reduced under a replacement 1993 trust deed and rules, which, crucially, purported to be retrospective to 1990; and
- the question was whether the trustees could rely on the supposedly retroactive lowering of the bar for making benefit changes and argue that the increases had (with the benefit of hindsight) been validly introduced.

The judge agreed that an exercise of the amendment powers in the 1993 deed with effect from 1990 involved '*re-writing history*', but concluded that it did not do so '*impermissibly*' (Doc Brown, take note). That was because the amendment could have been made under the previous powers, and the only reason that it was not was that the correct formalities were not observed.

Statutory limitation

Of more general interest, perhaps, was the judge's view that, had he ruled that the increases were *in*validly introduced, the trustees could (in principle) have recouped the resulting overpayments of pension from future pension instalments. He said that the six-year time limit contained in section 5 of the *Limitation Act 1980* did not apply to such '*equitable recoupment*', contrary to some Pensions Ombudsman's determinations. However, it was noted that if the member disputes the amount owed, the trustees cannot proceed with recoupment until '*the obligation ... has become enforceable under an order of a competent court*'. In the judge's opinion, a PO determination in the trustees' favour would not of itself count as '*an order of a competent court*'; if the member fails to accept the PO determination, the trustees could obtain an order from the County Court, which would enable them to proceed with recoupment.

[7] *Burgess & others v BIC UK Ltd* [2018] EWHC 785 (Ch).

The judge considered whether the trustees' delay in asserting their rights would prevent recoupment, under the doctrine of *laches*. He said that it would need to be considered by the trustees on a member-by-member basis, as laches usually applies when a person is able to show that the application of a remedy would be unfair because that person changed his or her position in the meantime.

There seem to be several interesting pensions-law aspects to this judgment, with varying degrees of nerd-appeal. There will be speculation about whether it heralds a more-relaxed approach to missing amendment formalities. The potential for recovering overpayments by offsetting them against pension instalments will be of interest to trustees who are unable to recoup their losses fully by getting the member to write a cheque.

NEST consultation response

The National Employment Savings Trust (NEST) has announced the outcome of a consultation exercise on proposed rule changes, issued in November 2017.[8] The changes are intended to reflect Government amendments to the legislation governing the NEST, and to improve the operation of the scheme for employers and members.[9]

The main proposals were to:

- allow employers and members to join the scheme via bulk transfers without consent and contractual enrolment;
- provide for payment of lump-sum death benefits regardless of whether a member died before or after age 75, reflecting changes to the pensions tax rules in 2016;
- allow members to opt for death-benefit lump sums to be paid, at the NEST's discretion, to either members' nominees or their personal representatives (at the moment, death benefits are payable under a binding nomination process which results in them forming part of a deceased member's estate for inheritance tax purposes); and
- give the NEST corporation the ability to give notice to employers that have not made contributions recently (within the last year, say) informing them that their participation in the scheme will be ended unless a contribution is made during the notice period.

Following the consultation, the NEST Corporation decided to implement the above changes, with the exception of the proposal allowing members to choose to have death benefits paid at the NEST's discretion. Respondents thought that the proposed approach would have significant communication challenges and that member inertia may result in a very low take up of the option. The NEST plans to carry out further analysis and to introduce an appropriate rule change in the coming year.

Some respondents also raised concerns about the proposal to terminate participation of employers who have not made recent contributions. It was suggested that the requisite period of dormancy should be at least a year, and potentially three years to cater for re-enrolment; and that employers could have the option to continue to participate despite having made no contributions within the period. This change is going ahead, however, as the NEST Corporation has said that the rule does not require it to fix the period, but rather leaves it to the Trustee to determine. It has no plans to implement the termination policy in the short term, and will take respondents' comments into account when it does.

[8] NEST Reponse to Rules consultation – March 2018, <www.nestpensions.org.uk/schemeweb/nest/nestcorporation/news-press-and-policy/thought-leadership-and-consultations/consultations.html>.

[9] See *Current Issues* December 2017, <www.hymans.co.uk/news-and-insights/research-and-publications/publication/current-issues-december-2017/>.

Most of the changes had effect from 6 April 2018. Contractual enrolment will only be offered from 25 May. The associated changes to the NEST Order came into force on 1 April 2018.[10]

HMRC newsletters

Her Majesty's Revenue and Customs (HMRC) has published the first edition of a bulletin devoted to its new online 'Manage and Register Pension Schemes' service.[11] The newsletter provides details of the new digital platform for scheme registration and administration.

From 8 May 2018 the service will be used for applications to register pension schemes. The intention is that its functions will be extended next year, to allow scheme administrators (and practitioners authorized to act on their behalf) to use it to meet their reporting obligations under the tax legislation.

The latest edition of HMRC's *Countdown Bulletin*, dedicated to the end of contracting out, is also available.[12]

Pension Ombudsman change of address

The Pension Ombudsman moved to new offices[13]. Its postal address is now

10 South Colonnade
Canary Wharf
E14 4PU

The change of office follows the recent announcement that the Pensions Advisory Service (TPAS)'s dispute-resolution function moved to the Pensions Ombudsman from 1 April 2018.[14]

[10] See *Current Issues* February 2018, <www.hymans.co.uk/news-and-insights/research-and-publications/publication/current-issues-february-2018/>
[11] <www.gov.uk/government/publications/pension-schemes-manage-and-register-pension-schemes-service-newsletter-april-2018/pension-schemes-manage-and-register-pension-schemes-service-newsletter-april-2018>.
[12] <www.gov.uk/government/publications/countdown-bulletin-33-april-2018/countdown-bulletin-33-april-2018>.
[13] <www.pensions-ombudsman.org.uk/2018/03/new-hq-for-the-pensions-ombudsman/>.
[14] See *Current Issues* March 2018, <www.hymans.co.uk/news-and-insights/research-and-publications/publication/current-issues-march-2018/>.

And Finally…

This column has in the past expressed a fascination with abstruse matters of Parliamentary etiquette. *AF* has recently found himself wondering about the rules around written question submitted by MPs, and the responses from Ministers. Specifically, what is it that accounts for the near-saintly restraint demonstrated by the latter, in some of their answers? Is it simply a matter of patience, and good manners; or do the diplomatic skills—and red pens—of civil servants come into play to moderate any replies that lean toward the sardonic? Is it politics, or politesse? The public deserves to know.

For instance, *AF* spotted this question, asked on 18 April 2018:

> '*To ask the Secretary of State for Work and Pensions, what the timescale is for completing the automatic enrolment review that commenced in 2017.*'[15]

The reply from Parliamentary Under Secretary of State Opperman—or Pension Guy, as we like to call him—began:

> '*The review of automatic enrolment was completed and published in December 2017.*'

AF would have been tempted to stop there, or append a 'Do try to keep up, old bean.' The Guy's answer, on the other hand, diluted any hint of rebuke by going on to helpfully summarize the conclusions of the review.

Now, cynics might speculate that in that example, political necessity, to wit an understandable desire not to upset members of the DUP, might have played a part; however, it's not an isolated case. If it please the Court, we enter into evidence another example, also from April this year:

> '*To ask the Secretary of State for Work and Pensions, when she plans to complete the bulk pension transfer of employees working in Devonport Dockyard; and if she will make a statement.*'[16]

Now, it may be that the first part of the question was merely the pretext upon which the questioner hoped to goad the Secretary of State into commenting on a contentious issue. The answer, coming from That Guy again [*What, Esther, you too important?*] was quite terse, by Written Answer standards:

> '*The Government has no such plans as it is not the sponsor of the scheme for employees of the Devonport dockyard. The arrangements for transferring employees' pensions is a matter for the employer and the trustees of the scheme.*'

Just once, *AF* wishes to see a Minister draw inspiration from social media and reply, '*Epic fail* <facepalm emoji>' …

[15] <www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2018-04-18/136412/>.
[16] <www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2018-04-17/136208/>.