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Facilitating investment in illiquid assets

The Department for Work and Pensions (DWP) has announced the outcomes of two recent consultation exercises, and proposed some additional changes, on the theme of defined contribution (DC) scheme investment.[1] There are proposals for trustees to disclosure their illiquid-investment policies, for those with at least £100 million in scheme assets to explain their default asset-class allocations in their annual governance (Chairs') statements, and for the relaxation of employer-related-investment restrictions in larger master trusts (those with 500 or more participating employers). For the consultation outcomes, the Government will take more time to consider its proposals for the exclusion of '*well-designed performance fees*' from the default-funds charge cap; and will not introduce new measures during 2022 to influence market consolidation.

Background

The issue with performance fees, illiquid assets and the charge cap is one to which the Government has turned several times in the last two years.[2] In *Enabling Investment in Productive Finance* (November 2021) it mooted the idea of exempting '*well-designed performance fees*' from the cap. Summarizing the response, the DWP says that there was a '*mixed reaction*' to the proposal, which was '*not positively received or supported across the entirety of the pensions sector and other interested groups*'. As a consequence, it will '*take time to fully understand all the concerns raised… and… how these concerns might be addressed*'.

Policies on illiquids

In the meantime, the DWP proposes to require that DC trustees disclose and explain, in their statements of investment principles (more likely their default-arrangement SIPs[3]), their policies on illiquid investment. In the space of one-to-three paragraphs, it would like them to describe (amongst other things) the average percentage holding and type of illiquid assets, and the perceived benefits of those assets; or, conversely, why they choose not to hold such assets in the default arrangement. The consultation paper puts forward two possible ways to define '*illiquid assets*': the Government prefers a more-granular definition based on the ease with which the asset can be sold (for example, '*assets that are not able to be*

[1] <www.gov.uk/government/news/dwp-proposals-to-help-pension-schemes-boost-investment-diversity>.
[2] *Improving outcomes for members of DC schemes* (September 2020), *Incorporating performance fees within the charge cap* (March 2021).
[3] The consultation paper is unclear and seems to cite the wrong regulation.

sold without a significant notice period'), rather than one that operates by reference to the investment vehicle or its characteristics.

Asset allocation

The DWP also plans to make trustees of schemes with assets of more than £100 million (or perhaps £100m or more; the threshold is inconsistently expressed) explain their default asset-class allocation in their annual governance (Chairs') statements, and publish the information online. They would be obliged to disclose the percentages of the assets within their default arrangement that are allocated to—

- cash
- bonds
- listed equities
- private equity
- property
- infrastructure and
- private debt.

The consultation document contains an example of the proposed disclosures. Government guidance (rather than legislation) would provide much of the detail on how trustees should present the information. It proposes to require that trustees should show asset allocations at different ages (25, 45 and 55), as averages of the percentage allocations at four valuation points during the scheme year.

Hybrids

In schemes with both money purchase and defined benefits, the new requirements would apply only to the DC element. However, when determining whether a scheme is over the £100m threshold, total (DB + DC) assets, as set forth in the latest set of audited accounts, would be counted.

Rationale

The DWP repeatedly stresses that it is not seeking to force investment in particular asset classes, acknowledging that that '*would cut across the fiduciary duty to which trustees must adhere and the independence of pension scheme trustees from government policy objectives.*' Instead, it wishes '*to encourage further diversification and investment in assets that bring higher returns.*' It wants trustees '*to actively reflect on whether their current investment policies and asset allocations align with… market changes and if their current offerings are still in their members' best interests.*' It recognizes '*a need for investment platforms to innovate to accommodate long-term illiquid investments*', and that '*a cultural shift across the market needs to take place to make less-liquid assets a genuine option*', and hopes that its policy proposals will be influential.

ERI in authorized master trusts

Occupational pension schemes are subject to several restrictions on employer-related investments (ERI), to prevent improper or undesirable concentration of risk. The DWP has noted that where master-trust schemes serve multiple unconnected employers, compliance with the constraints can be onerous, and are likely to be excessive given the level of influence that those employers will have on the schemes' investment strategies. It proposes to amend the restrictions as they apply to master trusts with 500 or more actively participating employers, so that they only constrain investment in the scheme funder and scheme strategist (or those connected or associated with those entities). It estimates that 13 master trusts are currently within the scope of the proposal.

Next steps

Responses to the consultation proposals can be submitted at any time up until 11 May 2022.

It is good to see the DWP's continued interest in facilitating investment in illiquid assets, as it provides significant opportunities to improve financial outcomes for DC members and have a positive impact on the world around us, thereby encouraging greater engagement by savers with their pension arrangements.

DB & hybrid scheme return - changes to membership guidance

The Pensions Regulator has withdrawn guidance associated with this year's defined benefit (DB) and hybrid scheme return in response to feedback about inconsistencies in its advice about the classification of dependants. It has reverted to the version of the guidance used in previous years to clarify that dependants in receipt of pensions should not be counted as pensioners when answering the 'Scheme membership' question in the 'Scheme details' section of the return.

Trustees who have already submitted membership figures in accordance with the rescinded guidance are directed to revise the information to exclude dependants from their pensioner count. Although the scheme return deadline remains 31 March 2022, the Regulator will allow updates to membership data in Exchange until 31 May 2022. It will also delay sending out levy invoices until after mid-June 2022 to allow trustees time to amend their responses.

In addition to the questions on Exchange, schemes should be aware that they must also complete the new Part 1 questions that have been introduced this year.[4] These questions are not on Exchange and instead, can be accessed via a link in the initial scheme return request received from the Regulator.

Sunak's Spring Statement

The Chancellor of the Exchequer's Spring Statement (*#NotABudget*) announced… nothing that was directly pensions-related.[5] The primary threshold for payment of employee National Insurance Contributions will rise to meet (and remain aligned with) the £12,570 income tax personal allowance, with effect from July 2022; and the basic rate of income tax will be reduced (in England, Wales and Northern Ireland, at least) by one percentage point, to 19 per cent, in April 2024. There is also a five-pence-per-litre cut in fuel duty, for the next twelve months.

The *Spring Statement 2022* document details these (and other) policies.[6] It also says that the Government plans to '*share the proceeds of higher growth fairly with working people, through further tax cuts*', '*intends to make the tax system simpler, fairer and more efficient*', and '*will confirm plans for reforms to reliefs and allowances ahead of 2024*'.[7] It confirms too that '*efforts to reform… the pensions charge cap to unlock institutional capital into illiquid assets are ongoing.*'[8]

The NICs and income tax measures will provide some relief from cost-of-living increases. Of course, it is always worth checking any silver linings to see if they come attached to clouds. The changes come after recently announced *increases* to NICs rates and a multi-year freezing of the personal allowance and higher-rate threshold, so the overall effects will be less generous than they might at first appear. A lower basic rate also naturally means less basic-rate tax relief on employee pension contributions.

Lifting of the barriers to illiquid investments will allow defined contribution scheme members to access opportunities for improved longer-term net returns. Now is the time for trustees with the necessary governance capacity to explore this exciting development.

[4] <www.thepensionsregulator.gov.uk/en/trustees/submit-reports-payments-and-requests-to-us/scheme-return/db-and-mixed-benefit-scheme-return>.
[5] <www.gov.uk/government/speeches/spring-statement-2022-speech>.
[6] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1062708/Spring_Statement_2022_Print.pdf>.
[7] Pages 2, 33, & 43.
[8] Page 39. This is a reference to previously announced plans to exclude certain performance fees from the scope of the charging restrictions applicable to the default investment arrangements in defined contribution schemes used for automatic enrolment.

Temporal limit on age discrimination unlawful

An employment judge has cast doubt on a pensions-law provision that limits the effect of an age-based non-discrimination rule to periods of service since 1 December 2006.[9]

Occupational pension schemes are, by statute, taken to include a rule preventing discrimination based on certain '*protected characteristics*', including age. There are exceptions to the prohibition of age-based discrimination, though. The relevant one in this case is that there is no breach of the non-discrimination rule if the problematic treatment relates to rights built up during pensionable service prior to 1 December 2006, the date when protection from age discrimination first applied.

The employment tribunal case is the latest skirmish in a series of actions challenging the compensation restrictions within the rules of the Pension Protection Fund (PPF). The PPF takes over responsibility for private-sector, defined-benefit, occupational pension schemes that are left significantly underfunded when the sponsoring employer becomes insolvent, and pays compensation to their members. The level of compensation provided by the PPF differs depending on whether or not the individual member has reached normal pension age (NPA) at the time of the insolvency event: the rules favour those over NPA. Whilst a scheme is being assessed for entry into the PPF, its trustees must restrict their benefit payments to PPF-compensation levels.

The scheme at the heart of the case began to be assessed for entry into the PPF in July 2006, and remains under assessment currently. Members of the scheme (and claimants in the current case) have already been successful in challenging aspects of the PPF compensation restrictions. They have obtained court rulings that the employees of insolvent employers must receive at least 50 per cent of the values of their accrued pension entitlements[10], and that the cap on compensation for members below NPA at assessment represents unlawful age-based discrimination[11].

In the latest bout, members of the scheme have claimed that the restriction of the benefits paid to them during the assessment period constituted unlawful direct age discrimination. As their pensionable service ended before 1 December 2006, the '*temporal limitation*' on the effectiveness of the non-discrimination rule stood in their way.

Following a preliminary hearing to decide whether the Employment Tribunal has jurisdiction to hear the claim, the judge concluded that this temporal limitation is incompatible with EU law (as retained by the UK since Brexit), and should be disapplied. His ruling relied heavily on the UK Supreme Court's decision in the *Walker* case, which involved a different temporal limitation in UK law, affecting the prohibition of discrimination on the basis of sexual orientation.[12]

This was only a preliminary ruling (a further hearing was scheduled for 22 March 2022), and Employment Tribunal decisions need not be followed in other cases. Nevertheless, trustees should be alert for further developments on the matter. Pre-1 December 2006 benefits may have been put to one side when scheme rules were scrutinized for age-discriminatory effects, in reliance on the now-imperilled temporal limitation.

[9] *Mr D Beattie & others v 20-20 Trustee Services Limited and Federal Mogul Limited* (Case No: 2204554/2021 and others) <assets.publishing.service.gov.uk/media/61fa90f78fa8f53890ff389c/Mr_D_Beattie__vs__20-20_Trustee_Services_Limited.pdf>.

[10] *Hampshire v Board of the Pension Protection Fund* (European Court of Justice Case C 17/17).

[11] *Secretary of State for Work and Pensions v Hughes* [2021] EWCA Civ 1093.

[12] *Walker v Innospec* [2017] UKSC 47.

Fraud levy hike enabled

The Department for Work and Pensions (DWP) has, as proposed, cleared the way for a potential 2.4× increase in the fraud compensation levy, which could see it rise to £1.80 per member (a lower cap of £0.65 per member will apply to defined contribution master trusts).[13] Calls for a review have been rejected.[14]

In November 2020, the High Court gave a ruling confirming that the Fraud Compensation Fund (FCF), which makes payments to occupational pensions schemes that suffer losses attributable to dishonesty, may in some circumstances accept claims arising from pensions liberation fraud.[15] The FCF does not currently contain enough funds to meet the costs of such claims, which the DWP estimates at £250m. In April 2021, the Pension Protection Fund (PPF), which administers the FCF, increased the fraud compensation levy to the maximum level then allowed by legislation (£0.75 per member). The *Compensation (London Capital & Finance PLC and Fraud Compensation Fund) Act 2021* enabled the DWP to lend money to the PPF so that it can meet the near-term claims costs.

In November 2021, the DWP announced its intention to increase the cap on the levy from 75p per member (30p for master trusts) to £1.80 per member (65p for master trusts) from 2022/23.[16] This, it said, would allow the PPF to set the levies at levels that will enable it to repay the Government's loan by 2030/31.

The DWP has now confirmed that the levy changes will go ahead, even though most consultation respondents thought that the increases should be postponed pending a reassessment of the FCF, which was never designed to cover pension liberation fraud. The DWP rejected the case for an urgent review, but said that it will monitor developments and decide whether action is warranted. Amending legislation has been laid before Parliament and will come into force on 1 April 2022.

Trustees should brace themselves for substantial increases on last year's levy, and if necessary check their rules and contribution arrangements to see who will ultimately bear the extra cost.

Public Service Pensions and Judicial Offices Act 2022

The *Public Service Pensions and Judicial Offices Act 2022*, which contains the primary legislation necessary to correct the '*McCloud*' discrimination problems in the public service pension schemes, received Royal Assent on 10 March 2022. It also enables changes to the employer cost-cap rules, for the 2020 and subsequent valuations, and allows the Government to take action to prevent local-authority pension managers from (as the Government's spokesperson put it) '*pursuing their own foreign policy agendas.*'

The cost-control amendments will refocus the mechanism on the costs and benefits in the reformed, career-average-revalued-earnings schemes, and allow for the introduction of an 'economic check'. The latter innovation will mean that breaches of the cost ceiling or floor will only necessitate benefit or contribution changes if they are still required once certain long-term economic factors—excluded from the basic calculation—are taken into account. It is intended to prevent reoccurrence of the '*somewhat perverse outcome*' (in the GAD's formulation) of the 2016 calculations, which identified a cost-floor breach despite a concurrent discount-rate change that had triggered employer-contribution increases; had benefit improvements been made in response to that cost-floor breach, they would have pushed employer costs even higher.

A late introduction to the Act, section 100 enables the Government to issue guidance or directions about investment decisions that are at odds with *'UK foreign and defence policy*'. It will circumvent a 2020 Supreme Court ruling that found historical guidance to be unlawful.[17] Viscount Younger of Leckie, representing the Government in the House of Lords, confirmed whilst discussing the successful amendment that the Government still intends *'to bring forward wider legislation on BDS* [boycotts, divestment and sanctions], *when Parliamentary time allows, to ban public bodies from imposing such boycotts and divestments*.'[18] Such guidance or directions '*would involve extensive engagement with the LGPS community*', and '*would not seek to restrict decisions that meet the Law Commission's test for investment decisions*

[13] *The Occupational Pension Schemes (Fraud Compensation Levy) (Amendment) Regulations 2022* (SI 2022 No. 259).
[14] <www.gov.uk/government/consultations/review-of-the-fraud-compensation-levy-ceiling/outcome/government-response-review-of-the-fraud-compensation-levy-ceiling-2021>.
[15] *Board of the Pension Protection Fund v Dalriada Trustees Ltd* [2020] EWHC 2960 (Ch).
[16] <www.gov.uk/government/consultations/review-of-the-fraud-compensation-levy-ceiling/consultation-on-the-review-of-the-fraud-compensation-levy-ceiling>.
[17] *Palestine Solidarity Campaign v Secretary of State for Housing, Communities and Local Government* [2020] UKSC 16.
[18] *Hansard*, House of Lords Debates, 9 March 2022, Column 1443 <hansard.parliament.uk/lords/2022-03-09/debates/EBB0BC61-5642-4948-BC7F-B960229EE2CA/PublicServicePensionsAndJudicialOfficesBill(HL)#contribution-3DBDFDD9-0F5A-479D-B92C-A245A84DF97C>.

influenced by non-financial considerations except in a very narrow area concerned with UK foreign and defence policy'.[19] Section 100 came into force on 1 April 2022.

Since Royal Assent, there has been an armada of secondary legislation, mainly to ensure the orderly closure of the legacy, final-salary schemes on 31 March 2022, and move their active members into the reformed, career-average-revalued-earnings schemes for service from 1 April 2022 onward.

Dormant assets scheme encroaches on pensions

The *Dormant Assets Act 2022* gained Royal Assent on 24 February.[20] It allows (amongst other things) personal pension providers to transfer unclaimed benefits into a special fund that can redistribute them in support of good causes.

The dormant assets scheme has its roots in the *Dormant Bank and Building Society Accounts Act 2008*. It permitted the re-direction of money held in accounts that had not been accessed for fifteen years, for which no owner could be found, for use in '*meeting expenditure with a social or environmental purpose*'.

There are important safety features built into the system. Participation in the scheme is voluntary, participating institutions are expected to prioritize finding owners for dormant assets, and funds can be reclaimed by any owners who subsequently come to light.

The 2022 Act expands the scheme in part to cover *'eligible pension benefits'*. That is, money purchase benefits that have become payable under personal pension schemes. Benefits provided out of with-profits funds are excluded, and personal pensions offered by mutual insurers do not count either. The Act also establishes a legal basis from which participating institutions can be required to take steps to trace and verify the identity of rightful owners of the assets concerned.

Pension benefits are considered '*dormant'* if the owner:

- has died, leaving no surviving beneficiaries;
- has died, and at least seven years have passed without communication from beneficiaries or personal representatives;
- would be at least 120 years old, and at least seven years have passed without any such communication; or,
- became entitled to income withdrawal at the end of a pension contract, following which at least seven years have passed without any such communication.

The features of the dormant assets scheme are such that the denizens of the occupational pensions world are quite unlikely ever to encounter it, even indirectly, in their official capacities. However, the 2022 Act equips the Treasury with power to extend the scheme further, so it cannot be completely ignored.

Revaluation statutory instruments

Public Sector pensions

The *Public Service Pensions Revaluation Order 2022*[21] applies to accruals in the reformed career average (CARE) public-sector schemes. Benefits at the end of the 2021/22 scheme year will be increased at the start of the 2022/23 scheme year by 3.1 per cent, to the extent that the scheme rules refer to changes in prices; and by 4.1 per cent where they look to changes in the general level of earnings.

Section 148 Order

The 'section 148 order' that applies to the revaluation of GMPs during active service, and in some cases for early leavers, has been laid before Parliament and comes into force on 6 April 2022.[22] This year's Order is based on a 4.5 per cent increase in the general level of earnings.

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[19] Column 1461.
[20] <www.legislation.gov.uk/ukpga/2022/5/enacted>.
[21] SI 2022 No. 215.
[22] The *Social Security Revaluation of Earnings Factors Order 2022*, SI 2022 No. 216.

And Finally…

The Department for Business, Energy and Industrial Strategy—the proper phonetic pronunciation of the abbreviation, DfBEIS, is 'dee for bees' (well it is now)—has confirmed that it will proceed with plans to restrict the appointment of corporate directors to company boards.[23] A corporate director will only be allowed to hold such a position if all of its own directors are 'natural persons' (i.e. human) whose identities have been verified.

Altogether now:

> *You make me feel*
> *You make me feel*
> *You make me feel like a na-tu-ral per-son…*

This could have implications for pension schemes with corporate trustees, a fact acknowledged by the Government when it says that—

> '*We have considered specifically how this range of principles will apply in the pension sector given the widespread use of the corporate trustee model in that context. Given that a corporate trustee is no different from any other limited company, it will continue to be permissible for specialist trustee providers to furnish schemes with professional board members in so far as that provider, as the corporate director appointee, maintains all-natural person directors on its own board.*'

AF is looking forward to hearing anecdotes about conversations in which professional independent trustees are asked to confirm that they are '*all-natural*'…

[23] *Corporate Transparency and Register Reform White Paper* (February 2022) <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1057833/corporate-transparency-white-paper.pdf>.

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