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Current issues

March 2020

Articles this month:

Pension Schemes Bill developments: climate change, etc.

The *Pension Schemes Bil*l had its Second Reading in the House of Lords on 28 January 2020, and began its Committee Stage on 24 February 2020. In preparation for the latter stage various amendments were put forward including, most notably, new Government clauses that would enable it to impose governance and disclosure obligations on the trustees or managers of occupational pension schemes in the area of climate-change risk.[1]

Hodge-podge

Most of the amendments do not emanate from the Government. They are diverse. There are attempts to restrict the scope of the new criminal offence for those guilty of '*conduct risking accrued benefits*'; to subject distributions by public companies to approval by trustees and the Pensions Regulator, or make the declaration of a dividend bigger than the employer's annual deficit-repair contribution a 'notifiable event' in cases where the scheme deficit is more than five times the size of that contribution; to oblige the Regulator '*to promote the membership of defined benefit schemes*' (because one can never have too many clashing objectives); and to require the Government to establish a Commission to review public policy regarding pension schemes and make recommendations.

At the time of writing, only two (Government) amendments have been accepted. They are designed to ensure that collective money purchase schemes are covered by the annual charge cap of 0.75 per cent of the value of fund or equivalent combination charge, as well as benefit from other existing charge-control measures (e.g. the restrictions on early exit charge cap and the member-borne commission ban).[2]

Amendments to the new criminal-offences clauses were either withdrawn or not debated. Earl Howe on behalf of the Government gave examples of the types of activities that the clauses are intended to cover:

- '*the sale of an employer with a defined benefit scheme without replacing an existing parental guarantee over the employer's section 75 debt, resulting in the loss of the guarantee, including failing to tell the trustees about the sale in advance*';
- '*purchase of a company, subsequent mismanagement of that company and extraction of value prior to it going into administration*'; and

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[1] *Pension Schemes Bill [HL]: Running List of All Amendments in Grand Committee* <publications.parliament.uk/pa/bills/lbill/58-01/004/5801004-RL.pdf>.
[2] <bit.ly/2Tcxmyy>.

- ‘*stripping of assets from the employer, resulting in a substantial weakening of support for the scheme*’.[3]

He also said that it is ‘*not the Government’s intention to interfere with routine business activities*’. He notes that prosecuting authorities will have regard to their own prosecution policy and the Code for Crown Prosecutors when deciding whether to initiate criminal proceedings, and that they are unlikely to do so if they think that there are insufficient grounds or it is not in the public interest.

Climate change

The new governance clauses were laid before Parliament by Baroness Stedman-Scott, the Department for Work and Pensions (DWP)’s representative in the House of Lords. They would empower the DWP to make regulations compelling trustees to take action ‘*with a view to securing that there is effective governance of the scheme with respect to the effects of climate change.*’ In this context the ‘*effects of climate change*’ are said to include risks arising from steps taken (by governments and others) because of climate change, as well as opportunities relating to climate change.

The proposed amendment contains examples of the sorts of things that could be required:

- reviewing a scheme’s exposure to certain risks;
- formulation and maintenance of a strategy for managing a scheme’s risk exposure;
- setting targets relating to a scheme’s risk exposure;
- measurement of performance against those targets;
- assessment of a scheme’s assets in a particular way; and
- documentation.

There would also be a regulation-making power that could be used to oblige trustees to publish information about the effects of climate change on their scheme and make it available free of charge. The Pensions Regulator would be given power to enforce compliance, with penalties of up to £5,000 for individuals and £50,000 for companies in the event of a breach. Last month Guy Opperman, the Pensions Minister, indicated that the DWP would publish ‘*game-changing guidance on climate-related financial disclosure*’ during March 2020.[4] Following the tabling of the amendments, he tweeted that the Government would consult on its proposals.[5]

The DWP has also written to Charles Counsell, Chief Executive of the Pensions Regulator, with its thoughts on how the Regulator can integrate climate-change risks and opportunities into its activities.[6] The letter says that climate change is a priority for the DWP and the Government, and places the subject in the context of the Regulator's statutory objectives in order to show that it has an important role to play in helping pension funds deal with the material financial risks that arise. The DWP expects the Regulator to outline its strategy for dealing with climate-related financial risks, and the resourcing implications thereof. Guidance drafted by the Pensions Climate Risk Industry Group (in which the Regulator participates) will be incorporated into a Code of Practice (readers may recall that the Regulator needs to revise the governance aspects of its existing Codes in order to ensure UK compliance with the EU’s IORP II Directive). The letter also sets out the DWP's thoughts on the sorts of in-depth research that the Regulator should conduct in this area (to inform a report on climate-change adaptation that the Regulator has committed to produce by the end of next year).

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[3] <bit.ly/2Tr4bXB>.

[4] *Hansard*, House of Commons Debates, 27 January 2020, Column 511, <hansard.parliament.uk/commons/2020-01-27/debates/AA548F5C-DAD2-4AAA-BFC6-B0238631E2F3/PensionFundInvestmentsClimateChange>.

[5] <twitter.com/GuyOpperman/status/1227496125428457475>.

[6] <www.gov.uk/government/publications/climate-change-risks-and-opportunities/letter-to-charles-counsell-chief-executive-of-the-pensions-regulator-february-2020>.

Committee concerns

Two different House of Lords select committees have expressed misgivings about aspects of the Bill. The Constitution Committee (CC)[7] and the Delegated Powers & Regulatory Reform Committee (DPRRC)[8] are both uneasy about the 'Henry VIII' powers (those permitting changes to primary legislation without an Act of Parliament) that the DWP has arrogated to itself. They are also anxious about the proliferation of powers that require positive affirmation by Parliament (i.e. both Houses must pass resolutions in their favour) when first used, but thereafter allow changes subject only to the *negative* procedure (i.e. they become law by default and are only struck down if a motion to object is passed by either or both Houses).

The CC says that the Government must explain why proceedings in pursuit of the new criminal offences in connection with DB schemes can be kicked off by the Regulator or DWP without the imprimatur of the Director of Public Prosecutions. It is also critical of the '*skeletal*' provisions on pensions dashboards. Whilst recognizing the difficulties entailed, it says that '*complexity is not an excuse for taking powers in lieu of policy development.*' The suggestion is that the Government ought to have confined itself to those powers necessary to get the project going.

The DPRRC chastises the Government for failing to explain the need for an unqualified power to make a DB scheme's choice of chairperson subject to conditions, rather than setting out the restrictions in the Bill, or limiting the sorts of terms that might be imposed. It is also uneasy about the breadth of the power to make the statutory right to transfer subject to new constraints.

Amendments that do not start out with, or gain, the support of the government of the day have low chances of making it into the resulting Act of Parliament. Politicians know that, and often table them to raise awareness of an issue or test government policy.

Government amendments are much more likely to successfully run the gauntlet. The new governance clauses are quite radical, and show that the DWP at least is taking the threat of climate change seriously. However, they have the potential to cut across trustees' fiduciary obligations. The Government's consultation proposals will be awaited with interest.

Although the drafting of the criminal offences clause is arguably too broad, the Government's comments on the kinds of activities that the offences are intended to cover and the considerations for instigating prosecutions may provide some comfort.

HMRC pragmatic (so far) on GMP-equalization tax issues

Her Majesty's Revenue and Customs (HMRC) has published a first instalment of guidance on the tax issues arising from equalization of pension rights for the discriminatory effects of guaranteed minimum pensions ('GMP equalization').[9] Equalization-driven increases will not be treated as 'accrual', and so will not need to be tested for annual allowance purposes, or cause loss of lifetime allowance protections. Nevertheless, there are complications to be managed, and issues—most glaringly concerning GMP conversion—that are yet to be addressed.

HMRC's general approach

The broad message is that, for tax purposes, a pension increase resulting from GMP equalization is attributable to membership between 17 May 1990 (the date of the Barber judgment) and 5 April 1997 (when GMP accrual stopped, across the board), rather than an entirely new entitlement to benefits. HMRC has therefore concluded that an equalization increase will not by itself constitute fresh accrual for annual or lifetime allowance purposes. That means that it should not generate annual allowance charges or trigger loss of lifetime allowance protections; it will,

[7] <publications.parliament.uk/pa/ld5801/ldselect/ldconst/22/2203.htm>.
[8] <publications.parliament.uk/pa/ld5801/ldselect/lddelreg/17/1703.htm>.
[9] *Guaranteed Minimum Pension (GMP) equalization newsletter - February 2020* <www.gov.uk/government/publications/guaranteed-minimum-pension-gmp-equalisation-newsletter-february-2020/guaranteed-minimum-pension-gmp-equalisation-newsletter-february-2020>.

however, affect the amounts crystallized for lifetime allowance purposes by past and future benefit crystallization events.

Annual allowance

increases that are purely the result of GMP-equalization adjustments will not

- bring those who were deferred members at the inception of the current tax regime (on 6 April 2006) and have remained so ever since within range of the annual allowance system;
- mean that members who became deferred on or after 6 April 2006 lose the benefit of the 'deferred member carve-out'; or
- necessitate the recalculation of historical pension input amounts for other members.

The opening and closing values for the tax year in which benefits are adjusted (and subsequent tax years) will have to reflect the member's equalized pension. The two values will effectively cancel each other out, so that no-one will be subject to an annual allowance charge purely as a result of GMP equalization.

Lifetime allowance

Protections

Similarly, GMP equalization adjustments ought not to invalidate the various flavours of lifetime allowance protection. However, the value of the rights protected will have to be revisited if a member has primary, individual or (in some cases) enhanced protection. For primary and individual protection, where HMRC has been provided with a figure for the protected amount, the member will need to update the value of the pension savings at the relevant date to take account of any increase. Some members (the newsletter suggests the category is restricted to those with 'individual protection 2016') will be able to do so via their online personal tax accounts; others will need to write to HMRC.

Broadly speaking, enhanced protection is lost, in a DB arrangement, when the value of the benefits paid or transferred exceeds that of the benefits on 5 April 2006, but with an allowance for indexation or salary increases since that date. Equalization increases will affect both values. Calculations for members who have accrued benefits since 5 April 2006 will need to be reconsidered in light of equalization (those who have not should be unaffected).

Where the result of equalization increases is such that a member would, with hindsight, have qualified for some form of lifetime allowance protection, HMRC will in some circumstances accept a late claim.[10]

Benefit crystallization events (BCEs)

Equalization increases will inflate the amounts crystallized in, and therefore the running total of the member's lifetime allowance used up by, past and future BCEs. A member who has already had a BCE may in retrospect be found to have incurred a lifetime allowance charge (LAC), or a higher LAC. Some members who previously expected to be able to take their benefits without incurring charges may now find that that is no longer true.

The annual lifetime-allowance statements provided to pensioner members will, following equalization increases, have to be revised to show the (higher) percentage of the lifetime allowance used up by the equalized pension.

Scheme administrators will need to amend historical Accounting for Tax returns and Event Reports if equalization increases mean that—in hindsight—the amounts reported were too low, or that reports that should have been made were not. They can apply to be discharged of their liability to a LAC where they reasonably believed that none was due (or thought that the LAC was lower than it turned out to be), and it would not be just and reasonable in the circumstances for them to be liable. The newsletter says that it is not possible for HMRC to say in advance whether the application for discharge will be successful.

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[10] Readers are directed to the *Pensions Tax Manual* <www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm098000> for details.

Scheme members may need to update past self-assessment tax returns to reflect the correct LAC position.

Pensioner payroll operators will need to deduct income tax, in accordance with the PAYE rules from any arrears of pension paid as a lump sum. This may result in overpayment of tax, in which case the pensioner will need to contact HMRC and supply details of the historical underpayments and the tax years to which were attributable, in order to have their tax corrected. Interest on the arrears will be a scheme administration member payment, which is an authorized member payment; the newsletter appears to suggest that such interest should be paid net of tax.

Still awaited

The guidance in the newsletter is concerned only with increases that are made directly to equalize for GMP differences. It does not cover any other benefit adjustments that might be made in association with an equalization exercise, for example where GMP is converted into other benefits of equal value following equalization. Work on the tax implications of conversion, as well as on payments such as trivial commutation lump sums and death benefits, is ongoing.

The Revenue's general position on GMP equalization increases is sensible and reflects the legal view that members have been entitled to equalized benefits for service since 17 May 1990. It appears that there should be no adverse annual-allowance consequences or invalidation of lifetime allowance protections. However, the administrative demands of revisiting BCEs and ensuring that the correct tax has been paid should not be underestimated. Note that there is no suggestion of the possibility of members applying to be discharged of their LAC liabilities, where these arise or are increased.

Note also that this newsletter deals only with cases in which a 'year-on-year' ('dual-records') approach to equalization is taken. Many schemes are leaning instead toward using GMP conversion to resolve the issue. Her Majesty's Revenue and Customs has yet to advise on the tax repercussions of that route.

Future of Trusteeship & Governance: consultation outcome

The Pensions Regulator has announced its plans following on from the *Future of Trusteeship and Governance* consultation exercise that it conducted in 2019.[11] [12] The themes include trustee knowledge and understanding (TKU), scheme governance structures (board diversity, professional trustees, and sole trusteeship), and defined contribution (DC) scheme consolidation.

TKU

The Regulator intends to review and update *Code of Practice No. 7: Trustee Knowledge and Understanding*, as well as its *Trustee Toolkit*. It hopes to consult on the revised material '*in the early part of 2021.*' Its expectations will reflect those expressed as part of the '21st Century Trusteeship' campaign, and will distinguish the different types of scheme (defined benefit, defined contribution, and public sector) and trustee (professional and lay trustees, as well as trustee chairpersons).[13] Once trustees have had time to absorb the new material it will start a new 'regulatory initiative', in the course of which it will contact large numbers of trustees in an effort to gauge how much they have learned.

It will not seek to have qualifications or continuous professional development (CPD) requirements included in legislation, acknowledging that there are different ways of attaining the necessary TKU. It indicates, however, that 15 hours and 25 hours of CPD per year might reasonably be expected, respectively, for lay and professional trustees (the Association of Professional Pension Trustees' accreditation standards require at least 25 hours a year relevant learning and development).

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[11] <www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/future-trusteeship-governance-consultation-response-february-2020.ashx>
[12] <www.thepensionsregulator.gov.uk/en/document-library/consultations/future-of-trusteeship-and-governance-consultation>
[13] <www.thepensionsregulator.gov.uk/en/trustees/21st-century-trusteeship>

It is planning a campaign to remind employers with occupational schemes about their legal obligations to give employees paid time off for any trustee duties and training, and suggest ways that they can support trustee recruitment.[14]

Scheme governance structures

The Regulator will form an industry working group tasked with promoting trustee diversity. It will not, for now, seek the creation of a new trustee duty to report on activities in furtherance of diversity.

It will *not* push for all schemes to have a professional trustee or for tighter rules for sole trustees. It will instead support the Association of Professional Pension Trustees' standards and accreditation framework for professional trustees, and in its intention to develop a code for sole trusteeship.[15] It also has plans for more research into the use of the sole-trusteeship model, and '*will continue to keenly scrutinize schemes that use a sole trustee.*'

DC consolidation

The Regulator will continue to monitor DC consolidation activity and participate in efforts to find solutions to problems like the existence of valuable member guarantees.

The Regulator is right to steer clear of fixing minimum qualifications and training-tallying obligations for trustees. Its plans to promote trusteeship with employers and encourage board diversity could help alleviate problems filling trustee vacancies, if done well. Press coverage of the announcements has so far focused on the Regulator's decision not to push its 'aspiration to see an accredited professional trustee on every board'; in truth, the Regulator was clear from the outset that such a goal was impractical, currently.[16]

FCA statement – disclosing charges and costs in workplace pensions

The Financial Conduct Authority (FCA) has published a policy statement setting out the outcome of last year's consultation exercise on disclosing costs and charges to defined contribution (DC) workplace pension scheme members.[17] In broad terms, it replicates, for contract-based arrangements, the costs and charges disclosure obligations that were imposed on trustees of occupational defined contribution DC schemes in April 2018.

Since 2018, FCA rules have required asset managers to report costs and charges to the scheme operator, manager or trustee of contract-based workplace pension schemes. The new rules build on this and require contract-based workplace pension scheme governance bodies (e.g. independent governance committees) and their advisers to disclose costs and charges information to scheme members on an ongoing basis.

The new rules, coming into force on 1 April 2020, are being phased in and will apply to default funds first. Scheme governance bodies will have until 31 July 2021 to publish details relating to default fund cost and charges for the 2020 calendar year. In subsequent years, the costs and charges on all funds that members can select will need to be disclosed annually by 31 July, in respect of the previous calendar year.

In the short term, providers will only have to publish costs and charges information on default arrangements, rather than full fund ranges. With this, the FCA is focusing on the importance of charges to those who (generally) do not make an active decision where to invest their pension assets. This seems logical and will cover the vast majority of members in DC arrangements.

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[14] Sections 58 – 60 of the *Employment Rights Act 1996*.

[15] Press reports have suggested that the APPT's accreditation scheme will open its doors in April 2020 (see for example 'Professional Trustee Accreditation to Launch in April', *Professional Pensions*, 11 April 2020 <www.professionalpensions.com/news/4010483/professional-trustee-accreditation-launch-april>). However, after the publication of the Regulator's plans the Pensions Management Institute announced its own (seemingly rival) accreditation programme <www.pensions-pmi.org.uk/news-and-publications/pmi-launches-accreditation-programme-for-professional-trustees>. At the time of writing it is unclear how this will affect the Regulator's decision.

[16] See pages 7 and 23 of the July 2019 consultation document.

[17] <www.fca.org.uk/publication/policy/ps20-02.pdf>.

Auto-enrolment qualifying earnings & trigger

The Department for Work and Pensions (DWP) intends to keep the auto-enrolment qualifying earnings band (upon which minimum contributions and benefits are based) aligned with the National Insurance Contributions thresholds.[18] From 6 April 2020 the qualifying earnings band will be from £6,240 to £50,000 per annum. The annual 'earnings trigger' above which jobholders must be enrolled automatically will continue to be £10,000, as it has been since 6 April 2014.

Government has said that it intends to remove the lower end of qualifying earnings band so that contributions are calculated from the first pound earned (as well as reduce the age threshold for auto-enrolment from age 22 to age 18) from the mid-2020s.[19] There are no current proposals to reduce the earnings trigger, however, we expect that it will be a subject of discussion at this year's statutory triennial auto-enrolment policy review.

PASA drafts DB transfer Code

The Pensions Administration Standards Association (PASA) has published a consultation-draft '*Code of Good Practice*' for defined benefit (DB) transfers.[20] The Code is intended to improve transparency and communication during the transfer process and strike a balance between protecting members and respecting the statutory right to transfer.

The PASA produced guidance for straightforward transfers last year. Rather than producing a second guidance note for non-standard transfers, as it had initially planned, it decided to create a Code that covers all DB transfers.

The draft Code's objectives are to:

- facilitate faster, safer transfers to improve the overall member experience;
- improve member and stakeholder communications and transparency in the processing of transfers; and
- improve efficiency for administrators.

Depending on the complexity of the case, the draft Code suggests that it should take between seven and ten days from receiving a transfer request to issuing a guaranteed quote (with an extra five days if referral to an actuary is required).

The consultation period is 11 February to 30 April 2020.

[18] <www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2020-02-13/HCWS116/>.

[19] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/668971/automatic-enrolment-review-2017-maintaining-the-momentum.PDF>.

[20] *Defined Benefit Transfers: Code of Good Practice* (draft) <https://www.pasa-uk.com/wp-content/uploads/2020/02/PASA-DB-Transfers-CODE-P1-10202020-FINAL.pdf>.

Auto-enrolment evaluation report 2019

The Department for Work and Pensions (DWP) has published its annual report on the effect that auto-enrolment has had on the workforce.[21] It is based on evidence published over the last 12 months as well as new analysis carried out for the report.

Some findings from the report include:

- more than 10.2 million workers have been automatically enrolled since 2012, with over 1.6 million employers meeting their duties under the auto-enrolment legislation;
- at the end of March 2019, NEST membership was 7.9 million members, with 720,000 employers participating (compared to 6.4 million members and 616,000 employers reported in the 2017/18 NEST annual report);
- 62 per cent of private sector employers have some form of workplace pension provision (up from 47 per cent in 2017); and
- the majority of individuals interviewed thought that auto-enrolment as a good thing for them personally and agreed that saving into a workplace pension was normal for them.

The DWP has confirmed that this will be the last evaluation report published by the DWP now that the implementation stage for auto-enrolment is over and the minimum level of contributions has been phased in.

Regulator's Compliance and Enforcement Bulletin

The Pensions Regulator has published its latest Compliance and Enforcement Quarterly Bulletin (covering October to December 2019) which includes a case study relevant to a current 'regulatory initiative' on the fair balance between deficit-reduction contributions and company dividends.[22]

The Bulletin notes that the Regulator has launched four 'regulatory initiatives' covering:

- fair treatment (pension scheme contributions versus dividend payments);
- lengthy recovery plans;
- investment governance; and
- record-keeping.

The 'initiatives' involve the Regulator directly contacting the trustees in writing, setting out its expectations and giving trustees a reasonable time to take action. An associated press release says that regulatory initiatives are prompting correspondence with 'hundreds' of trustees, with encouraging results so far.[23]

One of the case studies notes that as a result of being contracted as part of the 'fair treatment' regulatory initiative, the trustees and employer in question agreed an additional £15 million lump sum for the scheme.

The Regulator also notes that in light of the plans to tackle poor scheme governance, which includes updating the Trustee Knowledge and Understanding Code of Practice and reviewing the Trustee Toolkit, it will '*look to carry out a regulatory initiative to check levels of trustee knowledge and understanding, once these standards are in place*'.

[21] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/867634/automatic-enrolment-evaluation-report-2019.pdf>.
[22] <www.thepensionsregulator.gov.uk/en/document-library/enforcement-activity/enforcement-bulletins/compliance-and-enforcement-quarterly-bulletin-october-to-december-2019>.
[23] <www.thepensionsregulator.gov.uk/en/media-hub/press-releases/2020-press-releases/more-trustees-take-action-to-protect-savers-after-tpr-steps-up-communications>.

Statistical instrument round-up

PPF levy ceiling and compensation cap

The Pension Protection Fund and Occupational Pension Schemes (Levy Ceiling and Compensation Cap) Order 2020 has been laid before Parliament.[24] It sets the levy ceiling——one of the statutory features that restricts the total amount that the Pension Protection Fund (PPF) Board can try to raise in a particular year—at £1,099,445,505 for 2020/21. As a reminder, the PPF has announced that it intends to raise £620 million for 2020/21.

The standard amount of the compensation cap will be £41,461.07. This is the cap at age 65, without taking any account of long service, and before application of the 90 per cent factor that affects the compensation of members who are below normal pension age when the PPF steps in.

Social Security

The Treasury has laid (in draft) the legislation necessary to increase the National Insurance lower earnings limit to £120 per week (the upper earnings limit is still frozen).[25] It also sets the primary threshold (at which employees start to pay National Insurance contributions) to £183 per week, and the secondary (employer) threshold to £169 per week, from 6 April 2020.

Increases to social security benefits are confirmed in a separate draft statutory instrument.[26] So, for those who reached State pensionable age before 6 April 2016 the basic State pension will be £134.25 per week, and the additional State pension will increase by 1.7 per cent. The single-tier State pension will rise to £175.20 per week.

GMP Increase Order

The draft *Guaranteed Minimum Increase Order 2020* (set to come into force on 6 April 2020) has been laid before Parliament.[27] It will fix the increase in guaranteed minimum pensions (GMPs) accrued after 5 April 1988 at 1.7 per cent.

[24] SI 2020 No. 101.

[25] The draft *Social Security (Contributions) (Rates, Limits and Thresholds Amendments and National Insurance Funds Payments) Regulations 2020*, <www.legislation.gov.uk/ukdsi/2020/9780111192580>.

[26] *The Social Security Benefits Up-rating Order 2020*, <www.legislation.gov.uk/ukdsi/2020/9780111192344>.

[27] <www.legislation.gov.uk/ukdsi/2020/9780111192344>.

And Finally…

Is it just *AF*, or does the headline from Charles Counsell's recent blog—'*2020 Will Be A Year of Positive Change*'—make it seem like the Pensions Regulator is branching out into the tabloid horoscope business?

Expect to see the use of the Regulator's power to inspect premises announced with '*I see a tall, dark stranger in your future…*', and annual DB funding statements beginning with '*With Saturn rising in Libra, your lucky number is 0 (£deficit)…*'