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Current issues

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Expanding the scope of auto-enrolment

The *Pensions (Extension of Automatic Enrolment) (No. 2) Bill* received Royal Assent on 18 September 2023, becoming the *Pensions (Extension of Automatic Enrolment) Act 2023*. It gives the Department for Work and Pensions (DWP) powers to widen the criteria for auto-enrolment.

The Act allows the DWP to lower the age (currently 22) at which jobholders become eligible for automatic enrolment (AE), and to reduce or remove the lower limit of the qualifying earnings band (currently £6,240 p.a.), thereby increasing the statutory minimum levels of contributions or benefits that an AE-compliant scheme must provide. It also permits changes to the timing of the Government's (currently annual) reviews of the qualifying earnings band, and the factors that it may consider when setting it for the future.

When it reviewed the AE rules in 2017, the Government said that its ambition was to reduce the minimum age criterion to 18.[1] It also indicated that it wished to eliminate the lower limit of the qualifying earnings band altogether, so minimum contributions and benefits would be calculated on the first pound of earnings. A consequence of the latter development would be the removal of the category of 'entitled workers' (as the Pensions Regulator's describes them), who do not earn enough to be *automatically* enrolled, but are able to 'opt in' and oblige their employers to contribute on their behalf.

The Bill was fast-tracked, skipping the usual Committee and Report stages in the House of Lords. That is an indication both of the Government's resolve, and the cross-party support for the planned changes (none of their Lordships had indicated a desire to amend the Bill).

The DWP must engage in consultation before making the necessary regulations. Viscount Younger, the DWP's representative in the House of Lords, told the House that the consultation exercise would be held '*at the earliest opportunity*' and that '*We hope that it could be later this year.*'

[1] *Automatic Enrolment Review 2017: Maintaining the Momentum* (December 2017).

PPF 2024/25 levies: a new low (though not as low as they could be)

The Pension Protection Fund (PPF) proposes to collect just £100m in levies for 2024/25, half of the amount originally targeted for 2023/24, and to hold them at that level for the foreseeable future. The levies would be even lower but for the PPF's desire to retain some capacity to respond to sudden changes in circumstances. It estimates that 99% of schemes will receive lower levy bills compared to this year's.

Legislative shackles

The PPF's discretion over the levies that it charges is subject to statutory constraints. The least significant at the current juncture is the overall levy ceiling, which increases annually in line with earnings, and as of 1 April 2023 had reached a whopping £1,246,964,705. A more pertinent restriction is the rule preventing it from increasing its levies from one year to the next by more than 25%. Fundamentally, the PPF is obliged to impose both a risk-based and a scheme-based levy for each year, and to ensure that the former accounts for at least 80% of the total amount to be raised.

The effects of these restraints are illustrated in the 2024/25 levy consultation document. Without the changes that the PPF plans to make to target levies of £100m per annum, the 2024/25 levy estimate would be just £90m. And, in due course, the PPF '*would expect to be able to move to charging zero levy, only reintroducing the levy in the event of a significant challenge to its funding position.*'

An independent review of the PPF, commissioned by the Department for Work and Pensions (DWP) and reporting back in December 2022, resulted in a recommendation that it reconsider the legislation, so that the levies could be reduced easily whilst retaining the freedom to reintroduce or raise them again should circumstances change.

Proposed policy changes

Pending governmental action on this recommendation, which would necessitate amendments to primary legislation, the PPF has concluded that it should take steps to fix the levies at the level that it considers prudent in light of the current constraints upon its powers.

The main changes proposed for 2024/25 are:

- an increase in the risk-based levy-scaling factor, from 0.37 to 0.40, to raise the targeted £100m; and
- a reduction to the scheme-based levy multiplier, from 0.000019 to 0.000015, to maintain the minimum 80:20 split between the risk- and scheme-based levy components.

The PPF has retained the risk-based levy cap of 0.25% of a scheme's protected liabilities, but does not expect to apply it to any schemes. It has delayed adoption of the latest assumptions for s. 179 valuations, which would otherwise have reduced the targeted levy and the pool of levy payers, or forced an additional increase in the levy scaling factor (to the detriment of those still paying risk-based levies).

Future developments

Additional changes will be needed to keep the levy at £100m in later years, without unduly pressuring the evaporating pool of risk-based levy payers. The PPF is seeking views on possible alternative approaches, including increases to investment stresses and the introduction of an additional factor to scale up liabilities and increase the number of schemes that must pay risk-based levies.

It is also considering steps that it could take '*towards a simpler levy*', including:

- a very streamlined insolvency scoring model, or use of off-the-shelf credit scores or covenant-related information gleaned by the Pensions Regulator as part of the reformed funding regime, as an alternative to the PPF's bespoke insolvency-risk model;
- measuring only the risk of the dominant employers in multi-employer schemes;
- putting less emphasis on insolvency risk;
- reviewing its systems for collecting, managing and manipulating scheme data, for example its roll-forward approaches

The PPF says that it will work with the Pensions Regulator to clarify how assets should be reported.

The consultation period is from 11 September to 30 October 2023.

The main thing is honesty[2]

August and September 2023 brought us some meaty (in more ways than one) determinations from the Pensions Ombudsman's 'Dishonesty Unit'.

Background

The Pensions Dishonesty Unit was set up as a pilot exercise in November 2021, under the auspices of Anthony Arter, who was then the Pensions Ombudsman. When Arter was succeeded in that role by the current Ombudsman, Dominic Harris, in January 2023, he stayed on as a temporary and part-time Deputy, in part to see the dishonesty cases that he had begun through to their conclusion. The Dishonesty Unit pilot has funding through to March 2025.

Cases

There are some common threads to the two recent determinations. They are both concerned with (as the 'Pensions Dishonesty Unit' label might lead you to imagine) suspected scams. Both cases were given oral hearings, which is unusual for the cost-conscious Ombudsman, but reflects the seriousness of the allegations. Each resulted in an unusually lengthy determination report: 60 pages including appendix in one; 131 pages including appendices in the other. And in both examples a trustee was directed to return a six-figure sum (almost £215,000 plus interest in the first case; more than *£738,000* in the second) to the scheme. Oh, and for good measure, Arter reported all concerned to the Pensions Regulator, in the hope that it will take further action.

PO-28532 (Mr A, Mr S & Mrs S)

In the first case the sole trustee was directed personally to repay c. £215,000 plus interest to the pension scheme, as well as a total of £24,000 to the three complainants as compensation for '*exceptional maladministration*'. The bulk of the money that must be repaid represents the amounts transferred into the scheme by the complainants; the Ombudsman's direction was given on the grounds that the trustee had inappropriately invested the transferred-in funds, which subsequently evaporated. The principal employer/administrator of the scheme was also ordered to pay £3,000 to each of the complainants.

CAS-27569-X0V0 & CAS-73885-Q6V9 (Mr M & Mr Y)

In the second example, the Deputy Pensions Ombudsman concluded that the trustees had committed multiple breaches of trust and acts of maladministration. He said that the scheme's original trustee was unable to rely on exoneration and indemnity provisions in the trust documentation, and was accordingly personally liable to account for his actions. He was directed to pay (within 28 days) £738,768 to the scheme, and he and the administrator were to pay £6,000 (jointly and severally) to each of the complainants.

The legal test for dishonesty that the Deputy PO is working with may be a little different from that employed by the proverbial man on the Clapham omnibus. There's a taste of the issues at play in this sample sentence from the second of the two written determinations:

> '*So, although he* [the trustee] *may have been acting honestly by his own low subjective standards, I find that his own standards fell far below the objective standards of ordinary decent people.*'

[2] '*The main thing is honesty. If you can fake that, you've got it made.*' Attributed (probably incorrectly) to Groucho Marx. And George Burns. And Samuel Goldwyn.

Challenge to surplus-return plan rejected

The Pensions Ombudsman has concluded that a trustee's decision to pay surplus of approximately £12m to a scheme sponsor on winding up, without augmenting members' benefits, was properly made and could not be impeached.[3]

Scene-setting

Members of a section of a defined benefit (DB) scheme were told that it was being wound up, and that the trustee expected that excess assets would remain after their benefits were fully bought out and the expenses of winding up met. Although the trustee had discretion, in consultation with the section's sponsoring employer, to use the surplus to augment members' benefits, it had decided instead to pay it to the sponsor.

A scheme member complained that all of the contributions to the scheme were made for the benefit of its members, so that payment of the resulting surplus to the employer was '*morally indefensible*'. He said that the statutory process of inviting representations from members about the surplus proposal had been a 'tick box exercise'.

Jurisdiction

The Ombudsman is not permitted to make a factual finding that trustees have failed to comply with the statutory requirements for payment of surplus to a scheme sponsor. That is (presumably) because Parliament has given the responsibility to the Pensions Regulator, in the first instance. In wind-up cases, members must be invited to write to the Regulator if they suspect that the statutory procedure has not been followed; and before proceeding with the surplus payment, the trustees must obtain the Regulator's confirmation either that no member representations were received or that it is satisfied that the requirements were observed.

However, it *was* possible for the Ombudsman to investigate the member's complaint by focusing on the trustee's decision-making process and exercise of its discretion.

Determination

The Ombudsman concluded, after examining the evidence, that the trustee had followed the scheme rules, considered the appropriate factors, and reached a decision that was neither unreasonable not perverse.

He said that the trustee had correctly interpreted the scheme rules. In particular, it was right to treat the power to augment benefits as a discretion, so that it was possible for it to decide not to use the surplus assets in that way. The obligation to consult with the sponsor did not mean that it had an effective power of veto over augmentations and could therefore force the return of surplus. There was no evidence that the trustee had fettered its discretion by allowing the employer to have a veto power: the decision had been taken by the trustee, after considering the relevant factors (including the employer's request that the trustee consider returning the surplus).

The trustee had taken the relevant considerations (and no irrelevant ones) into consideration. Minutes of trustee meetings showed that it had taken into account the employer's view, the source of the surplus, member expectations, that benefits had been fully secured, past augmentations, and the employer's facilitation of the trustee's prudent funding and de-risking strategies. The Ombudsman examined these issues in some detail. For example:

- The member had confused terms in the trustee company's Memorandum of Association, which prevented distribution of excess assets to shareholders on a winding up of the company, with the rules of the pension scheme. The Ombudsman (unsurprisingly) said that they were not relevant to his investigation. Also irrelevant were the member's analysis and criticisms of the statutory provisions on return of surplus.
- The Ombudsman noted that the employer was itself a potential beneficiary of the scheme, because the scheme rules allowed for return of surplus. So it was rightly considered along with the other beneficiaries when the trustee exercised its discretion. Moreover, the courts had moved away from a simplistic formulation of the trustee's duty to act in the best interests of beneficiaries as a paramount standalone duty, instead seeing it as an aspect of the obligation to promote the purpose for which the trust was established. A trustee could serve the purposes of the scheme by deciding to return surplus, as allowed by the scheme rules, after fully securing the members' benefits.
- The trustee's view that it was the employer's contributions, and particularly the amounts paid in addition to regulator contributions, that had led to the surplus had been based on actuarial advice. A historical increase in a sub-group of members' contributions had been considered in that analysis.

[3] Mr S (CAS-92093-N4D9).

- During a data cleansing and GMP reconciliation exercise it was discovered that some members were receiving pensions that were higher than were due. A decision was taken not to continue with the pensions at that higher rate and not to recoup the overpayments. So there was a sense in which members had already benefited from the surplus.
- Statements in a member booklet about the use of scheme assets in any winding up, and their separation from the employer's assets '*would be open to a wider and different interpretation to that put forward by*' the member, who thought that they bound the trustee to use the surplus to augment benefits. The booklet did not contradict the scheme rules, and besides contained a disclaimer that it gave a simplified account of the rules and was subordinate to them.
- The trustee's surplus-distribution proposal was painstakingly explained during the member-consultation process. The arguments and complaints of members who opposed the plan were discussed at trustee meetings.
- There was no evidence that senior officials, representative of other scheme sponsors, on the trustee's board had been swayed by the prospect of future surplus payments to their own companies.
- Whilst another trustee might have (validly) reached a different conclusion, the decision not to use the surplus to augment member benefits was not unreasonable or perverse. The Ombudsman noted in this respect that the trustee had considered a previous award of extra service to active members on the closure of the scheme, and that the chosen buy-out insurer's actuarial factors were generally more generous to members than the scheme's had been.

The recent, felicitous turnaround in DB scheme funding in general means that more and more trustees will find themselves in the happy position of deciding how to deal with surpluses rather than worrying about deficits. In such cases the Ombudsman's discussion of the requirements for sound decision-making and procedural propriety may be instructive. Sponsors will also be reassured by his ready acceptance that their interests can be validly considered, and can even be preferred, when relevant.

Room for improvement: Regulator gets its report card

The Department for Work and Pensions (DWP) has published an independent reviewer's report on the Pensions Regulator. The reviewer concludes that the Regulator '*is overall well-run... and is generally well-regarded*', but identifies some areas where it could do better.

The review was led by Mary Starks (ex-Financial Conduct Authority and Ofgem). She identifies three broad themes and makes seventeen detailed recommendations.

Themes

Starks' first theme is risk and growth. She calls upon the Regulator to prove its worth in the aftermath of the September 2022 liability-driven investment perturbations, and in the ongoing productive-finance discussions. Under the headline of compliance and enforcement, she suggests that the Regulator needs to demonstrate its willingness to take tougher action and punish wrongdoers when necessary. Lastly, beneath the banner of digital transformation and value for money, Starks says that the Regulator's ever-burgeoning list of responsibilities bring a need to find ways of operating more efficiently.

Recommendations

Starks says that the Regulator should:

- continue to be a separate entity for now, but that the Government should continue to keep the regulatory framework under review;
- work with the Pension Protection Fund (PPF) to manage defined benefit schemes that are unlikely to achieve buy out;
- help determine how to interface with the Bank of England's Financial Policy Committee on financial stability, and whether it should have a formal stability objective;
- regularly review its role in monitoring asset allocations and driving investment behaviour that is in members' long-term interests;
- raise any concerns about gaps in regulatory oversight, noting in particular the possibility of extending its remit to the regulation of pensions administrators and authorization of professional trustees;

- work with the DWP to consider the options for delegating some rule-making powers (for example over information gathering) to the Regulator, enabling it to act without needing to wait for the DWP to legislate;
- review its enforcement approach, with the DWP to consider simplifying the rules on financial support directions ;
- look for cost-effective ways to incentivize auto-enrolment compliance from smaller, weaker employers;
- devise strategies both for driving consolidation of sub-scale, badly run schemes and for overseeing the largest, most-sophisticated ones;
- come up with options for drawing upon expertise from the pensions industry;
- seek ways to streamline its complex internal committee structure;
- evolve its approach to outcome and impact monitoring;
- review and improve its plans for efficiency savings;
- review its hybrid-working policy and the different needs of staff working at its Brighton headquarters and those based elsewhere; and
- develop its strategy for becoming more data led and digital.

On the Government's side, Starks recommends that:

- the DWP and Treasury should consider how to make the Regulator fully funded by the pensions sector, taking into account the need to recover the general levy deficit; and
- the DWP should put in place controls to keep the Regulator's budget in check.

DWP preserves selected EU legal obligations

The Department for Work and Pensions (DWP) has laid in Parliament draft regulations that would *'codify'* (that is, keep) some European Union-derived aspects of our pensions law that would otherwise bite the dust under the *Retained EU Law (Revocation and Reform) Act 2023*.

The principles that are to be codified are ones that were established through the courts:

- the need to equalize for differences attributable to guaranteed minimum pensions, without needing to identify an actual opposite-sex comparator (as established in the *Allonby* case)[4];
- the requirement to provide benefits for same-sex surviving spouses based on member service before 5 December 2005[5] (*Walker*); and
- the 50% minimum for Pension Protection Fund (PPF) compensation, and consequent unlawfulness of the compensation cap (*Hampshire* and *Hughes*)[6].

The first two rules will be codified by the *Pensions Act 2004 and the Equality Act 2010 (Amendment) (Equal Treatment by Occupational Pension Schemes) Regulations 2023*, whilst the latter will be covered by the *Pensions Act 2004 (Amendment) (Pension Protection Fund Compensation) Regulations 2023*.

The PPF has published guidance on how to test that the value of PPF compensation equals 50% of the value of scheme benefits, from 1 January 2024. It says that the guidance can be used for section 143 valuations and when trustees are restricting benefits during an assessment period.

The DWP had to act on these matters before the end of the year, otherwise the effects of the EU-derived court precedents would have fallen away. In November 2022, a Government spokesperson *indicated* that the UK would not codify the Hampshire or Bauer judgments. Hampshire established that members must receive old-age benefits worth at least 50% of the value of their accrued entitlements in the event of employer insolvency; Bauer said that in such cases Member States couldn't reduce scheme benefits if it put the member below the at-risk-of-poverty threshold determined by Eurostat. It seems as though the spokesperson either mis-spoke or that the Government relented on the former.

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[4] *Allonby v Accrington and Rossendale College* (ECJ Case C-256/01).
[5] *Walker v Innospec* [2017] UKSC 47.
[6] *Hampshire v Board of the Pension Protection Fund* (ECJ Case C 17/17); *Secretary of State for Work and Pensions v Hughes* [2021] EWCA Civ 1093.

Tweaks to tax law when insurers hit difficulties

The *Registered Pension Schemes (Authorised Member Payments) Regulations 2023*[7] allow top-up payments to annuity policyholders whose entitlements are subject to judicial write-down orders when their insurance company gets into financial difficulties.

The idea of a write-down order is to stave off a struggling insurer's insolvency by judicially reducing the value of its liabilities. Under changes introduced by the *Financial Services and Markets Act 2023*, the Financial Services Compensation Scheme will pick up the tab for the resultant deleterious effects on policyholders. The Regulations ensure that any such top-up payment will be taxed like pension income and will not be considered an unauthorized member payment.

Public sector round up

Investment governance

Lee Rowley (Local Government Minister) responded to questions about climate governance, and the meaning of '*proper advice*', in the context of LGPS investment. He said that the Government will announce the outcome of its September 2022 consultation exercise '*in due course*'; noted that the Department for Levelling Up, Housing and Communities (DLUHC) undertook not to impose new climate-governance obligations in 2023/24; and pointed out that the phrase '*proper advice*' is defined in the legislation in which it appears.

McCloud

The DLUHC published the Government's response to a May 2023 consultation on the *McCloud* remedy in the LGPS, which covered issues about aggregation, PSTC transfers, flexible retirement, divorce, injury allowances, excess teacher service, compensation and interest.

The Local Government Pension Scheme (Amendment) (No. 3) Regulations 2023[8] make changes to the statutory underpin that applied on the transition from the final salary to the CARE scheme, in 2014. The LGPS version of the *McCloud* remedy involves extending the underpin so that it does not only affect members who were within ten years of normal pension age at the time.

PLSA refreshes divorce charging guide

The Pensions and Lifetime Savings Association (PLSA) has updated its guidance on pension sharing on divorce. The guidance includes a revised schedule of recommended charges. According to the press release announcing the publication, the new guidance becomes effective on 2 January 2024.

HMRC Newsletters September 2023

His Majesty's Revenue and Customs (HMRC) issued a September 2023 edition of its *Managing Pension Schemes Service (MPSS) Newsletter*, which announces the launch of event reporting (giving details of circumstances giving rise to income-tax liabilities) for the tax year 2023/24 onwards, with the publication additional online guidance. The Newsletter also contains a reminder to file accounting-for-tax (AFT) returns for the third quarter of 2023 by 14 November.

Pension scheme tax returns for 2023/24 (which are only due if a notice to file is issued) will need to be submitted on the MPSS; HMRC is 'encouraging' timely migration to the new service (laggards may receive short-deadline filing notices).

[7] SI 2023 No. 1012.
[8] SI 2023 No. 972.

HYMANS ROBERTSON

And Finally…

In light of the tragic loss of our colleague Patrick Bloomfield, we are taking a break from our usual *And Finally* section in this month's *Current Issues*.

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