May 2019

In Sight

a quarterly pensions publication

This quarter's round-up

Regular features

New powers for the Pensions Regulator

The government has confirmed its intention to press ahead with many of the changes proposed in last year's consultation on strengthening the powers of the Pensions Regulator.

The DWP consultation – as reported in the August 2018 edition of In Sight – considered some of the ideas put forward in the government's white paper on protecting defined benefit (DB) pension schemes. The DWP's response confirms that most of the additional powers proposed for the Regulator will be taken forward and legislation will follow as soon as Parliamentary time allows.

Notifiable events

The range of notifiable events will be expanded – employers will be required to notify the Regulator of:

- The sale of a material proportion of a business or assets of a scheme employer that has funding responsibility for at least 20% of the scheme's liabilities.
- Granting of security on a debt to give it priority over debt to the scheme.

The existing notifiable event concerning wrongful trading of the sponsoring employer will be removed.

The definitions of the terms relating to the new events will need to be considered, as will the impact on business of changes to the existing framework. Consideration will also be given to changing the timing requirements for notification of events. The government will consult on the detail; and the Regulator will update its guidance on the notifiable events framework and consult on a revised code of practice.

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Declaration of intent

The government will legislate to require corporate planners (including sponsoring employers) to prepare a declaration of intent that will be shared with the trustee board and the Regulator, for the following events:

- Sale of controlling interest in a scheme employer.
- Sale of the business or assets of a scheme employer.
- Granting of security in priority to scheme debt.

The government will work with the Regulator on the content and timing of the declaration. The aim is to ensure that the impact of the event can be estimated, and mitigations put in place.

Penalties and information gathering

A more comprehensive regime will allow the Regulator/courts to impose the most appropriate penalty from a suite of options:

- Existing civil penalties for low-level non-compliance.
- Power to issue civil penalties of up to £1 million for more serious breaches.
- Criminal sanctions that would allow the courts to impose appropriate penalties for wilful or reckless behaviour (unlimited fines and/or custodial sentences) - or non-compliance with a contribution notice (unlimited fines).

The range of potential targets includes all those who have responsibility to the pension scheme – directors, sponsoring employers and any associated or connected persons, and in some circumstances trustees.

Following separate discussion with industry on measures in the white paper, the government will also proceed with proposals to give the Regulator increased information gathering powers, including a stand-alone interview power and greater power to inspect premises.

Anti-avoidance powers

It is proposed to strengthen and improve the existing framework of contribution notices (CNs) and financial support directions (FSDs), including by:

- Amending the reasonableness test for CNs so there is a stronger focus on the loss or risk caused to the scheme by the event. Currently there is a focus on the benefit the target, for example a parent, has extracted from the sponsor.
- Expanding the material detriment test for CNs so that this would be met if either: the amount the scheme would have recovered on a hypothetical employer insolvency is materially reduced because of the act, or the "value" represented by the employer provides materially less coverage of the scheme's section 75 deficit following the act.
- Making the FSD a single-stage process, renamed as a financial support notice.

The Regulator will also review its guidance on clearance (a voluntary process through which an employer can apply to the Regulator for confirmation that a CN or FSD will not be issued in relation to a particular event) to clarify expectations.

Equalising for GMPs – conversion guidance published

In the February 2019 edition of In Sight we reported on the Lloyds Banking Group High Court ruling that trustees have a duty to equalise benefits for the effect of unequal guaranteed minimum pensions (GMPs).

The ruling set out a number of options available to equalise for the effects of GMPs. One option - provided employer consent is obtained - involved conversion of GMPs into a different form of benefit of equal value. The DWP, with assistance from an industry working group, has now released guidance setting out how schemes could use the GMP conversion legislation to achieve equality going forwards. The government is not placing any obligation on schemes to use this method, and notes that the guidance may be amended in future. HMRC has also stated that it will provide more information and guidance through its pension schemes newsletters in the coming months.

In November we published an In Depth – Solving the puzzle – equalising for GMPs – that looked in detail at the implications of the High Court ruling, and the options available to trustees and employers for pension schemes with GMPs. A further In Depth publication will be available shortly focusing on the conversion option. This would avoid the need to maintain dual (or multiple) administration records into the future – and allow schemes to remove GMP liabilities through a one-off exercise, by converting GMPs into an alternative benefit in a form chosen by the trustees

Action

Equalising for GMPs is likely to be a significant project requiring careful planning, and most of the preparatory work will be required irrespective of the method eventually chosen. Deciding on the long-term solution will require discussion between trustees, employers and their advisers over the various options. Although conversion of GMPs is likely to be popular, there are significant issues to consider if conversion is to be adopted and trustees will need to work with employers to agree an approach that is acceptable to both parties.

Regulator's annual funding statement

The latest annual funding statement is primarily aimed at DB schemes that have a valuation date between September 2018 and September 2019 or are undergoing significant changes that require a review of funding and risk strategies. However, the messages are relevant to other schemes.

The statement covers:

- **Long-term funding targets**
  All schemes are expected to agree a long-term funding target (LTFT).
- **Balancing risks**
  Trustees must continue to consider integrated risk management, with a particular focus on the risks arising from scheme maturity.
- **Equitable treatment**
  Concern remains over the disparity between dividend growth and stable deficit reduction contributions (DRCs).
- **Long recovery plans**
  Schemes with strong covenants should generally have plans significantly shorter than seven years (the median recovery plan length according to the Regulator's data). The Regulator plans to engage, ahead of 2019 valuations, with those schemes for which it considers recovery plans to be too long.
- **Late valuations**
  Enforcement action can be taken where valuation deadlines are not met, but trustees will be supported if they cannot agree a valuation for valid reasons.
- **Brexit uncertainty**
  The Brexit situation is being monitored and further guidance will be issued if necessary.
- **The Regulator's powers**
  Several investigations are currently underway where the Regulator might use its powers to direct how a scheme's technical provisions should be calculated or deficit funded.

The scheme scenarios set out in previous statements have been significantly expanded, with a series of tables covering 10 categories, identifying the key risks and actions for consideration, depending on the scheme and employer characteristics. For the first time, the tables include the Regulator's expectations for investment strategies in the various scenarios. The tables distinguish between mature and immature schemes: maturity issues are expected to assume greater significance in the future.

In addition to equitable treatment regarding dividends, the Regulator is also concerned about other actions that could weaken the employer covenant and is actively intervening where it believes that schemes are not being treated equitably.

Its principles are:

- Where dividends and other shareholder distributions exceed DRCs, it expects a strong funding target and short recovery plans.
- For weak or tending to weak employers, it expects DRCs to be larger than distributions unless the recovery plan is short and the funding target is strong.
- If the employer is weak and unable to support the scheme, it expects distributions to have ceased.

Action

Trustees should take the Regulator's comments into account when considering their scheme's valuation.

The Money and Pensions Service

The single financial guidance body recently established under legislation has been officially named the Money and Pensions Service. It is the single source of government-sponsored financial guidance, responsible for the provision of pensions guidance, money guidance and debt advice.

This new body brings together the services provided by the Pensions Advisory Service (TPAS), the Money Advice Service (MAS) and Pension Wise.

The website is https://moneyandpensionsservice.org.uk

A customer website is set to go live towards the end of 2019 - until then, pensions guidance will continue to be available through the TPAS and Pension Wise sites.

Actions

Trustees need to update their signposting in member communications to direct members to the Money and Pensions Service.

If they have not done so already, schemes may also wish to update their member communications to reflect the transfer of TPAS' dispute resolution function to the Pensions Ombudsman last year. The disclosure regulations have not yet been properly updated to reflect this change, but the DWP and the Regulator have released a joint statement clarifying that schemes would not be penalised if they updated their signposting prior to the legislative requirements being corrected.

Long-term DC investment and consolidation

The DWP has been consulting on measures designed to encourage occupational defined contribution (DC) schemes to take a long-term investment approach and invest in less liquid assets such as housing, green energy and infrastructure. This follows recent papers from the Financial Conduct Authority (FCA) on proposals to facilitate investment in long-term patient capital, including real estate, infrastructure, private equity and start-up companies.

There are three key proposals:

- Larger DC schemes would be required to state their policy on illiquid assets in their statement of investment principles (SIP). They would then report on how they had followed this policy in their annual implementation statement, which DC schemes will be required to produce from 1 October 2020 (this is one of the new investment duties introduced by the DWP last year). Whilst there is not yet a firm proposal on the definition of larger DC schemes, the consultation suggests this would apply to schemes with assets above £250 million or £1 billion, or, alternatively, to schemes with at least 5,000 or 20,000 members. Schemes whose only DC benefits are AVCs would be exempt from this requirement.
- Smaller DC schemes would be required to assess whether their members would benefit from consolidating into a larger scheme, such as a master trust, in order to access a wider range of investments and improved standards of governance. They would report on this in the annual chair's statement at least every three years and after any significant change in scheme membership. It is suggested that this would apply to schemes with fewer than 1,000 members or, alternatively, to schemes with less than £10 million in assets.
- The introduction of an additional method to assess compliance with the 0.75% charge cap on DC default arrangements, to accommodate performance-related fees which are often levied on illiquid assets.

The consultation closed on 1 April; the DWP has not indicated when these requirements might be introduced.

Separately, the PLSA has published a new guide, *Patient capital made simple*, which aims to demystify the concept of patient capital and private markets investing and provide investors with a useful tool to aid discussions with trustees and members.

Master trust authorisation progress

The latest DC scheme return data (see page 5) indicates that membership of master trusts has increased to just over 13.4 million (from 270,000 at the beginning of 2012). Against this background, a new DC master trust authorisation regime was introduced in October 2018, with a six-month window for existing master trusts to apply to the Pensions Regulator for authorisation or to exit the market.

The Regulator's snapshot of the market at the 31 March deadline indicated that 30 schemes had applied for authorisation (of which three had been authorised), nine had exited the market and 34 had triggered their exit from the market. Extensions (of up to six weeks) were granted for 10 schemes.

The Regulator has published online a list of the schemes that are now authorised; at the time of writing, there are five authorised schemes. However, the Regulator has six months from receipt of application to make a decision on whether to authorise a scheme, so it could be some time before all schemes have an authorisation decision.

Other DC news

A reminder: new online DC disclosures

For scheme years ending on or after 6 April 2018, most schemes with DC benefits (except where all such DC benefits are AVCs), are required to make certain information from the chair's statement publicly available online. This includes information on costs and charges and content relating to the default investment strategy.

From 1 October 2019, these schemes will also need to publish their statement of investment principles (SIP) on the website. As reported in the November 2018 edition of In Sight, schemes must expand their SIPs to include new information such as how trustees take environmental, social and governance (ESG) considerations into account in their investment decisions. The SIP for any default arrangements must also be made publicly available online. From 1 October 2020 these schemes will also be required to publish an implementation statement online, setting out how they acted on the principles set out in the main SIP.

Information about how to access the website must be included in annual benefit statements.

DC winding-up guidance

The Pensions Regulator has published new guidance to help trustees understand the key steps involved in winding up a DC occupational pension scheme. The guidance is split into four areas to reflect the main stages of a wind-up:

1. Deciding whether the scheme should be wound up.

2. Preparing for and entering formal wind-up of the scheme.

3. Securing members' benefits.

4. Completing the process.

The guidance contains some useful links, such as those to help with the statutory requirement to notify the Regulator and HMRC that the scheme has been wound up.

DC scheme return data

The Pensions Regulator's scheme return data for 2018/19 provides a high-level summary of the current landscape of DC trust-based pensions in the UK, including information on the number and membership of schemes, as well as details on DC memberships of hybrid dual-section schemes. Key findings include:

- DC memberships continue to increase: 61% of all private sector workplace pension members (including active, deferred and pensioner) are in DC schemes.
- 90% of active members are investing into a DC scheme.
- in DC schemes with 12 or more members, 95% of members are invested in the scheme's default strategy.

FCA consults on the role of IGCs

The FCA is consulting on several new requirements for independent governance committees (IGCs) of contract-based schemes.

The first consultation will require IGCs to publish and disclose costs and charges information to scheme members. Since January 2018, fund managers have been required to provide information about transaction costs and administration charges to trustees and IGCs on request. The FCA is now proposing that IGCs will be required to pass this information on to scheme members, at least annually. The information would need to be published in the IGC chair's annual report and on a website, and to be given to members in an annual communication.

A subsequent consultation will introduce a duty for IGCs to report on their firm's ESG policies, as well as member concerns and stewardship, for the products that the IGCs oversee. IGCs will also be required to oversee the value for money of their firm's investment pathway solutions (see proposals below).

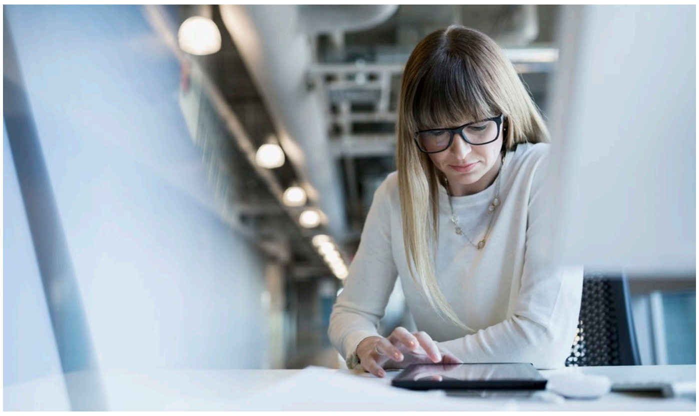
Similar requirements have already been put in place for trustees of occupational DC schemes.

FCA rules on wake-up packs and drawdown

The FCA's retirement outcomes review found that some individuals are at risk of losing out on pensions income as a result of the money purchase flexibilities introduced in 2015. In 2018 the FCA consulted on a package of measures to protect members of contract-based schemes (as reported in the August 2018 edition of In Sight). The FCA has now confirmed that the reforms to wake-up packs (which are sent to members before they decide how to access their pension savings) will apply from 1 November 2019; the packs will include a single-page summary, sometimes called a pensions passport.

The FCA has also undertaken a further consultation - this includes proposals for firms to offer drawdown customers who do not take advice a range of investment solutions that broadly meet their objectives, which it calls investment pathways. Final rules are expected in July 2019.

There are currently no plans for these changes to apply to trust-based schemes.



Pensions dashboards to go ahead

The government has confirmed that a system of multiple pensions dashboards will be introduced, enabling people to access information on all of their pension schemes in one place online.

In the response to its consultation on pension dashboards, the government says that it hopes to see prototypes created and tested this year. A delivery group, representing key industry stakeholders and led by the new Money and Pensions Service (see page 3) is due to be set up by the end of this summer, tasked with delivering the digital architecture that allows dashboards to work.

Legislation will be introduced at the earliest opportunity to compel schemes, with certain exceptions, to provide data that can be viewed through the member's chosen dashboard. There will be a staged roll out, with larger DC schemes being enrolled first and the majority of schemes going live within three to four years.

State pension data will not be included initially, but the government will work to make this happen as soon as possible.

The importance of good data

The Pensions Regulator has published three quick guides on record-keeping and member data to help trustees understand their responsibilities and the actions they are expected to take. Trustees have legal obligations that require them to maintain accurate and up-to-date records, including member data. The Regulator can take enforcement action against schemes that are not meeting these requirements and cannot demonstrate that they are taking steps to improve their records.

A quick guide to record-keeping summarises why record-keeping is important and the steps that trustees should be taking to ensure records are complete and accurate. Trustees are ultimately responsible for record-keeping and also need to have controls in place to ensure the security of member data, in order to comply with data protection law and protect against cyber attacks.

A quick guide to measuring your data sets out the data that trustees need to measure and how they are expected to calculate data scores so that data quality can be monitored. There are two categories of data:

- **Common data** consists of basic data items used to identify members, and are common to all schemes. Common data items include the member's name, date of birth, national insurance number and address.
- **Conditional data** is other member data that is key to running the scheme. This will vary between schemes depending on factors such as the type of scheme and the benefit structure. The guide explains that this is not all the data that a scheme holds, and trustees should work with their administrator to agree the data items that are counted as conditional data. Conditional data items could include salary records, service history, GMP entitlement and units held in money purchase funds.

Measuring data involves assessing whether each data item is present and whether it is accurate, which can include consistency checks between different data items, validation checks on the format of data items and specific processes such as pensioner existence checks. Separate scores for common and conditional data should be calculated as the percentage of members whose data is fully present and accurate. These scores are now collected by the Regulator as part of its annual scheme return process. We expect that the Regulator will monitor scores over time and may investigate where they do not improve.

A quick guide to improving your data sets out the Regulator's expectation that schemes should review their data at least once a year and, if there are any issues, put an improvement plan in place. An improvement plan should prioritise the data that has the greatest impact on member benefits. It should set out the objectives and outcomes that will be achieved, including how this will be measured and the timescales involved.

Corporate governance

Consultation on UK Stewardship code

The UK Stewardship Code seeks to enhance the quality of engagement between institutional investors, such as pension schemes, and the companies in which they invest. It sets out good practice for investors – signatories are required to report on their compliance with the code. It is acknowledged that pension scheme trustees may not wish to become directly involved in engagement with companies in which they invest, but they are encouraged to set mandates for their investment managers that require them to act in line with the code.

The Financial Reporting Council (FRC) has been consulting on a revised version of the code that sets substantially higher expectations for investor stewardship policy and practice, focusing on how effective stewardship delivers sustainable value for beneficiaries, the economy and society. The proposed changes will require signatories to:

- Report on how their purpose, values and culture enable them to meet their obligations to clients and beneficiaries.
- Take material environmental, social and governance (ESG) issues into account – this is in line with recent changes to investment duties for trustees of pension schemes.
- Exercise stewardship across a wider range of asset types (beyond UK listed equity) in the UK and globally.

The proposed code includes separate principles for asset owners, asset managers and service providers.

The revised code is expected to come into effect in July 2019.

Investment Association warning on executive remuneration

In the February 2019 edition of In Sight, we reported that, under the Investment Association’s updated guidelines on executive pay, companies should pay pension contributions to directors in line with the rate given to the majority of the rest of the workforce, rather than giving higher payments as a mechanism for increasing total remuneration. The Investment Association has now warned that it will ‘red top’ companies that pay newly-appointed directors pension contributions that are not in line with the rest of its workforce. A red top is the highest level of warning issued by the Investment Association's Institutional Voting Information Service, which provides shareholders with corporate governance research to aid their voting decisions at a company’s AGM. Where any existing executive director receives a pension contribution of 25% of salary or more, there will be an ‘amber top’ (a lesser warning) on the company's remuneration policy and remuneration report.

News round-up

New standards for professional trustees

A set of standards has been published that all professional trustees of occupational pension schemes will be expected to meet.

The standards are intended to improve the quality of professional trustees, provide assurance and discourage poor practices in the market. They cover matters such as fitness and propriety, governance skills, ongoing professional development and managing conflicts of interest. There are additional standards for professional trustees who chair or are the sole trustee on a board. An accreditation process will enable professional trustees to demonstrate they meet the standards; the framework for this is expected to be launched later this year.

The standards have been developed by the Professional Trustee Standards Working Group following a consultation at the end of 2017. They are voluntary but are supported by the Pensions Regulator and apply to anyone falling within the Regulator's description of a professional trustee.

Actions

Employers and other parties involved in appointing professional trustees to pension schemes should consider how those professional trustees intend to meet the new standards.

CDC schemes move a step closer

The government has responded to the consultation on collective defined contribution (CDC) schemes. CDC schemes would pool risks and costs between members, rather than each member having their own individual pot. They would offer a targeted - but not guaranteed - level of income in retirement, with the flexibility to adjust benefits if circumstances require. The employer would not be required to pay additional contributions to ensure that funding for a level of benefits remains on target.

Legislation for the CDC model set out in the consultation will be taken forward as soon as Parliamentary time allows. This will focus on CDC schemes set up by single or associated employers - the Royal Mail has been closely involved in developments and has a particular design in mind for its own employees. However, the aim is to legislate in a way that can quickly accommodate other models, such as CDC schemes run by master trusts, if appropriate in the future.

British Airways pension increase dispute

It has been reported that the long-running dispute relating to pension increases in the Airways Pension Scheme has been settled. The case considered whether the trustees could change the scheme's rules to enable them to grant discretionary pension increases.

Reports suggest that the parties have agreed that the trustees will have a power to award discretionary increases, subject to affordability tests, and that the proposed settlement will be put to the Supreme Court later this year.

New mortality projections model

The Continuous Mortality Investigation (CMI), a body owned and supported by the Institute and Faculty of Actuaries, has published its latest mortality projections model, reflecting mortality data up to the end of 2018. The new model, CMI_2018, projects lower future mortality improvements than previous versions and hence – all else being equal – will reduce pension scheme liabilities.

The lower projected improvements arise for two reasons:

- The additional year of mortality data continued the recent trend of low national mortality improvements.
- The CMI has recognised that this trend is likely to represent a shift to a new norm of lower mortality improvements, so it has adjusted the model to place more weight on recent mortality data.

The latest model also introduces a more intuitive way to adjust the results, to reflect that improvements for members of pension schemes may have been different to the population as a whole. The evidence indicates that mortality improvements for pension scheme members and for the better off have fallen but remain higher than those in the general population.

Overall, the new model could reduce a scheme's liabilities by between 2% and 6%, depending on factors such as the version of the model currently used, the scheme membership profile and financial assumptions.

Actions

Trustees and employers should consider using the latest CMI model and adjusting it appropriately for their pension scheme, whether for funding, accounting or other purposes.

New website for mid-life MOT

The DWP has launched a new website for what it calls a mid-life MOT – it is intended to help workers with advice on their pensions, working options and health. There are links to help people check their state pension entitlement and direct them to financial advice and guidance services. The DWP has also launched a guide for SMEs discussing how they can support their workers with the mid-life MOT.

Managing Pension Schemes online service

HMRC's online service for pension scheme registration and administration is now called Managing Pension Schemes. This platform was previously called the Manage and Register Pension Schemes service, but it has been renamed because HMRC thinks that this more accurately reflects what the service is used for.

The intention is that this site will hold everything relating to scheme administration, reporting and registration in one place. The service is being rolled out in stages and will eventually replace Pensions Schemes Online. HMRC's guidance on GOV.UK explains when the new service should be used and the information that is required in order to use it.

Pension Transfer Gold Standard launched

The Pensions Advice Taskforce (an industry-wide body set up by the Personal Finance Society, the professional body for IFAs) has launched the Pension Transfer Gold Standard (PTGS), a voluntary code of good practice for DB pension transfer advice. Financial advisers can adopt and promote this standard, which is intended to raise standards of pension advice and enhance consumer protection. Schemes are likely to be encouraged to include a copy of the consumer guide to the PTGS with transfer quotations so that members are aware of the standard of advice they should expect.

Actions

Employers and trustees should consider whether any IFAs that are promoted to members meet the new standard and may wish to highlight the PTGS to members, for example as part of any member option exercise.

On the horizon

Here are some key future developments likely to affect pensions:

2019

- Pensions Bill anticipated

October 2019

- Changes to investment duties, including the SIP and ESG considerations

Spring 2020

- New DB funding code expected to come into force

September 2020

- State pension age reaches 66 for men and women

October 2020

- DC schemes need to publish investment implementation report

Mid 2020s

- Changes to auto-enrolment proposed following 2017 review

Training and events

Dates scheduled for our pensions training seminars are set out below. Unless it says otherwise, all courses and events take place in central London.

You can find a copy of our training brochure and also book online at **aon.com/pensionstraining**

Pensions training courses	Dates
Defined Benefit — part 1 (one day)	2019 – 21 May (Birmingham), 24 July, 17 September (Leeds), 17 October, 26 November 2020 – 22 January, 25 February (Leeds)
Defined Benefit – part 2 (one day)	2019 – 14 May (Manchester), 12 June (Birmingham), 11 September, 12 November (Manchester), 11 December 2020 – 4 March
Defined Benefit Trustee Essentials (two days)	2019 – 17 to 18 July (Northampton), 9 to 10 October (Surrey)
Defined Contribution (one day)	2019 – 19 June, 6 November 2020 – 17 March
Pension Governance Committee (half day)	2019 – 24 September 2020 – 26 February

Other events

Aon participates in a variety of sector-specific conferences and exhibitions as well as holding regular seminars, webinars, conferences and events focusing on key issues of client interest.

To find out more about our events, go to:
www.aon.com/unitedkingdom/events/

Contacts

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