BROADSTONE

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1.1. Defined Benefit funding

If there is one area which is vexing the Government and the Pensions Regulator over most of the summer it has been the problems caused by underfunded DB schemes. It has been at the heart of 3 major issues. Firstly, the decision by Tata Steel to sell and the problems they have had in securing a buyer who will also take on the pension funding deficit. Secondly, the inquiry into the collapse of BHS, and the issues caused by their underfunded DB pension scheme. Thirdly, the use of arrangements whereby distressed employers are able to stop funding the scheme in return for the scheme restructuring and also avoiding the PPF.

British Steel

A short consultation was issued on options for helping the British Steel Pension Scheme. The following options are mooted (the consultation can be found here: https://www.go.uk/government/uploads/system/uploads/attachment_data/file/526731/british-steel-pension-scheme-consultation.pdf).

Option 1 – Use a Regulated Apportionment Arrangement (which exists now)

Option 2 – The employer pays the debt owed to the scheme to break ties

Option 3 – Reduce benefits (i.e. pension increases and revaluation to statutory levels

Option 4 – transfer benefits to a new scheme as part of a compromise – scheme would continue without an employer.

The consultation closed on 23 June 2016.

The issue for the pensions industry is whether the solutions specifically allowed for British Steel will become available for other UK employers to help deal with their DB funding problems.

Will the Government allow employers to force their schemes to use CPI rather than RPI, even where the rules specify CPI?

BHS and a further Defined Benefit Inquiry

The joint BIS and Work and Pensions Select Committee inquiry was, at times, exciting viewing. The Committee has now produced their report, which in the main focusses on the corporate governance issues that allowed BHS to collapse so spectacularly. However, there are questions to answer about the regulation of the pension fund and the attitude of the sponsor to make good the deficit. The Committee's conclusions included the following comments:

- "When Sir Philip Green bought BHS the pension schemes were in surplus. As these schemes declined into substantial and unsustainable deficit he and his directors repeatedly resisted requests from trustees for higher contributions. Such contributions were not charitable donations: they were the means of the employer meeting its obligations for deferred pay. Sir Philip had a responsibility to be aware of the growth of the deficit and he was aware of it. That there is a massive deficit is ultimately his responsibility.

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- The Committees say Sir Philip Green must act now to find a resolution for the BHS pensioners, a "moral duty" which will undoubtedly require him to make a large financial contribution. Sir Philip's failure until now to resolve the pension fund's problems contributed substantially to the demise of BHS, along with chronic under-investment and the systematic extraction of hundreds of millions of pounds from the increasingly ailing company.
- The Arcadia board cited a variety of explanations for pausing Project Thor, ranging from Christmas to the Scottish independence referendum and instability in Ukraine. In fact, the primary reason was Sir Philip Green's resistance to TPR's moral hazard requests. He did not wish to respond to requests for information regarding historic dividends, management charges, sale and leaseback arrangements, inter-company loans and the use of BHS shares or assets as collateral for company purchases. At best this demonstrated a lack of willingness to act to secure the pension fund's future."

There will now be a further inquiry by the Work and Pensions Select Committee into DB schemes "in their entirety" and would consider "radical solutions that could be more easily implemented if real returns on capital rise again". No date for this inquiry has been announced yet.

Halcrow

The Regulator has issued a section 89 Regulatory intervention report into the use of a Regulated Apportionment Arrangement by the Halcrow Pension Scheme. The report is long but summarises the issues faced to keep the scheme out of the PPF.

In brief, members were offered the chance to join a new scheme that provided benefits at a level higher than PPF but a lower rate than they would receive under the current scheme. The Regulator had to approve the arrangement and with no objection from the PPF.

The Halcrow solution has echoes with Project Thor proposed by BHS and it is possible that these solutions will become more common as more employers and trustees use these methods to help employers that could be rescued if they break the link with their DB scheme. If this is something that the Pensions Regulator and Government deems as a reasonable way to deal with DB pension schemes it is possible that further regulations would be required to make the process easier as the Regulated Apportionment Arrangement was not designed to be used in this way.

1.2. Ros Altmann goes Richard Harrington comes in

The period of stability given to us during Steve Webb's tenure between 2010 and 2015 is well and truly over, with Ros' removal (resignation/sacking) resulting in a new MP Richard Harrington being given the pensions brief. However, the status of the new minister has been relegated to the lowest rung of ministerial positions, that of a Parliamentary Under Secretary of State. This does hint at an internal move of focus away from DWP to HM Treasury.

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1.3. DWP consultation on exit charge cap

The aim is for schemes with "flexible benefits" to be treated the same between contract and trust based worlds. The Government would like, from April 2017:

- A cap on charges where a member leaves a scheme in order to access their benefits early
- Exit charges will not be completely removed – just set at an appropriate level
- A cap of 1% for existing schemes and 0% for new schemes is proposed
- Schemes will not be able to increase costs elsewhere to compensate

1.4. Lifetime ISA - Missing in Action?

The Pensions Industry awaits the regulations and Government's own impact assessment on the LISA's potential effect on auto-enrolment. Rumours have begun to circulate that it may be shelved or delayed.

Many providers have been stating that they won't be in a position to offer the product from April 2017 and the absence of anything concrete from the Government is throwing it into doubt.

1.5. Salary sacrifice - consultation

Following recent statements in Budgets and Autumn Statement the DWP have issued a consultation document looking at how the Government may curb the use of salary sacrifice arrangements. As previously stated pension contributions, childcare vouchers and health related benefits will remain unaffected but if the proposals go through where a benefit in kind is given via salary sacrifice it would now be chargeable to income tax and national insurance contributions. It would effectively create a situation where there would be no potential tax saving for the employee and no NIC saving for the employer.

The areas most likely to be affected will be to mobile phone, life insurance and car parking/car schemes.

1.6. Brexit and Integrated Risk Management

On 23 June 2016 British voters voted to leave the EU. In the weeks since we have seen significant market volatility, a downgrade to the UK's credit rating, a change in Prime Minister and ongoing political upheaval.

The Bank of England's decision on 4 August to cut interest rates for the first time since 2009, together with £70 billion of additional Quantitative Easing, added to Sterling's volatility and another fall in gilt yields contributed to further pressure on defined benefit scheme funding.

Trustees need to understand the impact on their schemes by identifying the key risks and agreeing potential ways to mitigate them. The Brexit Scenario, and the corresponding increase in risks, is exactly the type of scenario that the Integrated Risk Management framework, introduced by The Pensions Regulator, seeks to consider.

Employer covenant

Brexit will impact on the UK economy – potentially damaging an employer's ability to support the Scheme.

Trustees should consider the impact on employer profitability, cash-flow generation, recovery-plan affordability, and the risk of insolvency.

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Investment

The weeks following the referendum saw increased volatility across markets. Trustees and sponsors should:

- Consider which assets are most affected by volatility and exchange rate changes
- Consider their ability to deal with further shocks (falls in gilt yields, rising inflation, etc) and understand the options for reducing and managing risk
- Review de-risking plans and ensure funding and market triggers remain relevant
- Consider the outlook for UK property and the illiquidity of some property funds
- Consider expected disinvestments and the impact of volatile markets, potential illiquidity and higher trading costs.

Scheme funding

The weeks following the referendum saw increased volatility across markets.

In response to lower than expected growth the decision to cut interest rates has already impacted on the 20 year gilt yield. On 9 August, 20 year gilts yielded just 1.32% p.a. Put simply, this is bad news for DB schemes.

Trustees and employers should not take knee jerk decisions in relation to Brexit and the economy but assessing and understanding the risks posed by Brexit, and adoption of the Integrated Risk Management framework should be considered and discussed.

1.7. Secondary Annuity Market by April 2017

The Government are now committed to creating the space for people with annuities (bought before or after 6 April 2015) to sell these income streams. The price individuals receive can be taken as they see fit, but the resulting value will be taxed at their marginal rate.

The Government's focus will be on consumer protection, mindful of the potential for bad outcomes for individuals. Pension Wise will be expanded to provide support. A financial advice requirement (akin to the one needed when transferring safeguarded rights) will also be introduced.

The Government have also moved slightly on their position around "buy-backs" to the originating annuity provider. This may be permitted if the value is low (to be defined) or brokered via an FCA authorised intermediary.

Other issues on the agenda for consideration are an online rate comparison tool, a method for ensuring annuity payments cease on the death of the originating annuitant and protecting dependants who may lose death benefits.

2 THE PENSIONS REGULATOR

2.1 Money Purchase Code - slight revisions

2.2 21st Century Trustee

2.3 Committee submission hints at future regulatory regime

2.4 Reassuring statement

2.5 Scam Action

2.1. Money Purchase Code - slight revisions

The latest Code of Practice on the governance of Money Purchase schemes is now in force. The new Code will apply to trustees of: Occupational trust-based pension schemes; with two or more members (whether active, deferred or pensioner); and schemes that offer money purchase benefits (including Additional Voluntary Contributions (AVCs) within defined benefit (DB) schemes).

The new Code covers 6 broad areas:

- the trustee board;
- scheme management skills;
- administration;
- investment governance;
- value for members; and
- communicating and reporting.

The Code includes a raft of guides, best practice notes and checklists to help trustees to meet the code's requirements. They also give far more detail than is inCluded in the Code.

2.2. 21st Century Trustee

The Pensions Regulator has issued a discussion paper on what it is to be a trustee of a DB or DC scheme in the 21st Century. The discussion papers asks some questions of the pensions industry as well as exploring ways of changing the communication methods used by the Regulator.

Some question areas:

- Exploring the role of the trustee Chair
- Awareness of trustee Knowledge and Understanding framework
- Whether professional trustees should be required to be qualified or registered by a professional body,

The Regulator goes on to make a number of observations across a wide range of topics:

- Effective trusteeship and governance are key underpinning factors in achieving good member outcomes – it is essential that those responsible for running pension schemes and entrusted with members' savings are the right people with appropriate knowledge and skills and have the right scheme management processes in place.
- Trustee boards should reflect a diverse and balanced range of skills and experiences; this would include a balance of professional and lay trustees.
- The rise of professional trustees correlated with the rise in governance requirements is an area of focus from the Regulator.
- A more formal role for the Chair of a DC scheme's board of trustees has developed and the Regulator mulls over expanding the DB Chair's position. Standards may also be improved by the Regulator imposing a minimum level of experience, qualification or requirement the Chair is a member of a professional body.
- There are concerns around the awareness of the trustee Knowledge and Understanding programme. The Regulator is considering making it mandatory for Trustees to pass all relevant modules within 6 months of appointment or six-month probationary period for prospective trustees to complete the modules before the appointment is formalised.

2 THE PENSIONS REGULATOR

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- The Pensions Regulator does not expect all trustees to be professional but expects them to act professionally.
- Conflicts of Interest remains a major issue, with a large number of trustees "volunteered" by the employer and half of chairs selected by the employer. The area of conflicts of interest is up for review.
- Online tools will be reviewed to help trustees get what they need from their advisers. Small and medium schemes will also be assisted in getting more involved with administration, record keeping and investment governance.

What do Trustees have in store?

- More help to trustees to identify training needs.
- Help in setting investment strategies and identifying risks.
- Tools to help Chairs get more out of their advisers.
- The Regulator also makes a rather ambitious suggestion that sub-standard schemes (DB and DC) could be consolidated.

2.3. Committee submission hints at future regulatory regime

The Pensions Regulator made a written submission to the BHS inquiry with hints at ways it would like the pensions regulatory regime to be improved, highlighting the following areas.

- Information – more flexible and more for gathering information and even requiring parties to attend an interview.
- Clearance – certain corporations could require Regulator involvement earlier for instance, where there is significant underfunding and/or risk to the scheme's security.
- Risk based balance – the Regulator would like more involvement in the approval of and setting limits to recovery plans for high risk schemes and oversight of the employer's covenant and attitude to the scheme. This would be correlated with a reduction in the oversight for well run and well-funded schemes. There may also be a shortening of the 15 month deadline for the submission of valuations for all schemes.
- Chair's statement – this has recently been introduced for DC schemes and something similar could be introduced for DB scheme. There is also the talk of encouraging DB schemes to consolidate as this may prove beneficial (in the eyes of the Regulator).

2.4. Brexit - reassuring statement

TPR issued a statement following the UK's decision to the leave the EU which resulted in some considerable market volatility. The statement emphasised the long term nature of trustees' investments.

trustees were urged not to overreact in a knee jerk manner and review the impact of the Brexit decision on the employer covenant. They should also consider the scheme funding and any change to cash flow requirements and liquidity. As the implications become clearer, Trustees of DC schemes may want to review default arrangements to ensure they remain fit for purpose.

2 THE PENSIONS REGULATOR

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2.5. Scam action

The Regulator has appointed an independent trustee to the London Quantum Retirement Benefit Scheme. TPR had serious concerns about the governance standards of the scheme and the investments the scheme was using, which its members may not have understood. It is understood that £5.8m worth of investments are at risk.

The scheme was set up by Quantum Investment Management Solutions LLP to enable 3 people to invest just over £600,000 in a company called London Quantum One Limited. Payments totalling £600,000 were paid out in the following 7 months. The Pensions Regulator was concerned that the scheme was a liberation scheme. The scheme was expanded via an introducer's framework and offered a range of nine risky scheme investments, of which most were highly illiquid and two had been served an Action Fraud notice. Almost 100 members have transferred in.

The Pensions Regulator has recently published a determinations panel finding report from February 2016 which found that Dorrixo (the trustee) was

- Breaching duty to invest in a prudent manner
- Not taking proper investment advice
- Lack of diversification for a scheme of over 100 members
- Lacking competence and capability as a trustee, including not appointing an auditor, keeping appropriate records and failing to inform members of the risks associated with investments.

3 PENSION PROTECTION FUND

3.1 Factor changes

3.2 2016 strategic plan

3.1. Factor changes

The PPF has announced changes to early retirement factors and cash commutation factors that will apply to PPF benefits with effect from 1 October 2016.

For details, see here:

http://www.pensionprotectionfund.org.uk/TechnicalGuidance/Pages/TechnicalGuidance.aspx

Commutation factors are changing very slightly. Late retirement factors have also been reviewed, but are not changing.

However, early retirement factors will become less generous. For example, a member with NPA 65 retiring at age 60 early will see their early retirement pension reduce by c5.5% from 1 October.

Trustees of schemes in a PPF assessment period should consider whether they want to communicate the change to early retirement terms to deferred members, who could be better off taking retirement ahead of 1 October.

3.2. 2016 strategic plan

PPF have given details of their strategic plan, with the highlights as follows:

- Schemes potentially covered by the PPF currently have an aggregate deficit of £302.1 billion
- As at March 2015 it says it has an 88% chance of being self-sufficient around 2030 (down from 90% in March 2014)

Looking forward to 2016/17 to 2018/19

- LDI portfolio will be managed in-house (should produce savings, but they don't appear in the budget)
- Revamp to communications promised
- Number of PPF and FAS members is predicted to grow by 18% to 440,000 by 2018/19

Issues are the growing PPF universe deficit and deficit reduction contributions are on a downward trend from 2012. This was not the plan and the potential risk from future claims does not seem to have diminished.

4 AUTO-ENROLMENT

4.1 TPR's GPP List - starts

4.2 Work and Pensions Select Committee report on A/E and Government response

4.3 Automatic enrolment - phasing legislation

4.4 NEST consultation

4.1. TPR's GPP List - starts

The Pensions Regulator has started a list of GPPs open to any employer. Aviva's company pension is the first one on the list. These GPPs should be open to all employers and the pension should have been assessed by the provider's Independent Governance Committee. This is to help publicise well run master-trusts and GPPs which will help small and micro-employers find suitable schemes for their employees to meet their auto-enrolment obligations.

4.2. Work and Pensions Select Committee report on A/E and Government response

The report highlighted auto-enrolment as a success story, but there are:

- Concerns over the existence of "potentially unstable Master Trusts".
- Concerns that LISA will distract from the aims of auto-enrolment and calls for the Government to undertake research into LISA's impact.
- Concerns on the clarity of the liability of employers if their chosen pension fund for auto-enrolment performs badly.
- Calls for more support for small and micro employers.

The Government has responded which means that legislation will be forthcoming to tackle the problem of "unstable Master Trusts", which will be included in the Pensions Bill currently winding its way through the Parliamentary process. The Government has acknowledged concerns employers had regarding the potential liability when making scheme choices for their workers, but employers should be able to evidence they had due regard when making scheme choices.

The Government has also promised an impact assessment on LISA's impact on automatic enrolment. There is requirement in law to review automatic enrolment in 2017.

4.3. Automatic enrolment - phasing legislation

The announcement to delay the phasing in of increased minimum contributions for automatic enrolment compliance has been legislated for in the Employers' Duties (Implementation) Regulations 2016.

These will mean that the increase due from October 2017 of 5% of band earnings, with a minimum employer contribution of 2%, will now come in force from April 2018. The next step up to 8% of band earnings with an employer contribution of 3% originally due from October 2018 will now come into force in April 2019.

4.4 NEST consultation

NEST, the government's qualifying scheme for automatic enrolment, is subject to a consultation to review whether its remit could be reviewed to better reflect changes in the pensions landscape, especially around pension freedoms.

The consultation asks

- whether members should be able to access their benefits directly from NEST using flexible access and drawdown solutions
- Allow access to self-employed
- Accept transfers from non-members, including bulk transfers from other schemes and individuals close to retirement who may wish to access the new decumulation services (see first bullet point)

The consultation closes on 29 September 2016.

5 TRUSTEESHIP

5.1 Employer duty of care to employees

5.2 Scams

5.1. Employer duty of care to employees

The Pensions Ombudsman has ruled that (in a particular set of circumstances) the employer had a duty of care to advise pension scheme members of the tax implications of certain activities.

Summary of facts:

- The case concerns pension protection pension age where, generally, the earliest age a pension can be accessed is age 55, unless a protected pension age exists.
- One condition is that the member cannot retire using the protected pension age and then be re-employed within 6 months (or within one month on the same role).
- 3 South Wales police officers accessed the pension benefits before age 55.
- They were re-employed within one month.
- Their benefits were subject to a tax charge.
- The Pensions Ombudsman upheld the complaints and the employer should pay the tax charge.

Pension Ombudsman cases do not set precedent and it can be argued that, in this case, the direct nature of the involvement of the employer to trigger the tax charges perhaps make this a unique set of circumstances where the conclusion is reasonable. A case in 2014, where a member accrued an annual allowance tax charge, was found in favour of the trustees, which meant they had no obligation to advise the member of the potential charge.

With increasing complication with regard to tax and pension (e.g. tapered relief for high earners) it is possible the Pensions Ombudsman will take a different view in cases such as these.

5.2. Scams

The High Court has ruled on the case of Hughes vs Royal London. The member in this case wanted to transfer to a SSAS invested in Cape Verde islands. Royal London said no, as she didn't (in their view) have a statutory right to a transfer. They cited the "earner" link and that she wasn't employed by a body linked to the pension scheme. The Pensions Ombudsman agreed. However, the High Court didn't and ruled that she was an "earner" (albeit from a source unconnected to the scheme). This meant she was entitled to a transfer.

This is a major development, as the Pensions Ombudsman had 200 or so cases on his books which hinged on this point. There would now be no reason to delay the transfer payment. We'll soon see a trickle of PO rulings telling schemes to pay the transfer value.

This makes fraud much easier, and may prompt a change in emphasis in the narrative. If the scheme has complied with the Regulator's guidance and issued warnings about scams and fraud – if people still want to risk losing their money, perhaps they should be permitted to proceed. We have been discussing scams for years and we will be discussing it for years to come and it's a shame that one brick in the defensive wall for trustees to use has been removed.

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