SLAUGHTER AND MAY

Pensions Bulletin

March 2020

Welcome to the March 2020 Pensions Bulletin from Slaughter and May. In this month's Edition, in addition to covering the impact for pension schemes of COVID-19, we take a high-level look at the Pensions Regulator's consultation paper on the new funding regime for DB schemes; pensions measures in the Budget; new requirements on climate change risk management and reporting; HMRC guidance on GMP equalisation; and the further announcement from the PPF on levy changes

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I. Impact of COVID-19 on pension schemes

As with every other area of business, the COVID-19 pandemic has brought with it urgent practical and financial difficulties for pension scheme trustees and their sponsoring employers, and for scheme administrators.

In the ***COVID-19 Bulletin*** *we consider the recent announcements from the Pensions Regulator, as well as the statement from the Board of the Pension Protection Fund and questions arising from the Coronavirus Job Retention Scheme (the "CJRS") to be operated by HM Revenue & Customs, and the emergency voluntary leave ("EVL") included in the Coronavirus Act 2020.*

II. Funding of DB schemes: Pensions Regulator consultation

The first of the two consultations on DB funding sets out how the Pensions Regulator intends to regulate funding under a Code of Practice, based on the new funding and investment strategy, introduced by the Pension Schemes Bill, and eight principles of compliance. The Regulator says it will review the timing on the consultation, due to close on 2 June, in the light of COVID-19. The second consultation, originally scheduled for later this year, will cover the wording of the new Code of Practice, as well as a more detailed look at issues such as enforcement.

Although the proposals mirror the recent change in the Regulator's approach to the supervision of DB funding, focusing on the need to adopt a long-term funding objective and targeting schemes that are deemed to be higher risk, trustees will need to show compliance, rather than the onus being on the Regulator to supervise. Trustees and sponsoring employers will want to consider the implications for their schemes of the proposed new funding framework.

We will examine the detail of the proposals in a future bulletin, but the key points are:

- Trustees will have to choose between Fast Track compliance (with minimum regulation) and Bespoke (likely to result in greater regulatory involvement).
- For Fast Track, a scheme would have to satisfy (on an ongoing basis) each aspect of a set of compliance guidelines. Under the Bespoke approach, schemes would have to provide evidence explaining how and why they have differed from Fast Track and how additional risks are being managed (by contingent assets or guarantees, for example).
- Schemes would be required to have a long-term objective that, by the time they are significantly mature (15-20 years from now), they would have a low level of dependency on their employer – in other words, a low chance of requiring further employer support and, if support is needed, the amount is low relative to scheme size.
- Schemes should also be invested with a high resilience to risk and trustees will need a journey plan, with a clear link to the long-term objective, for investment risk to decrease as their scheme matures and reaches low dependency.
- The investment strategy should be broadly aligned with the funding strategy. There will be a "pass or fail" test – if the scheme does not comply with the investment risk guidelines it will have to reduce the level of risk or demonstrate support through Bespoke.
- Deficits should be recovered as soon as affordability allows, while minimising any adverse impact on the sustainable growth of the employer. The Regulator proposes to set clear expectations on "scheme equitability" – the treatment of the scheme compared with payments to other stakeholders, such as dividends.

III. Budget 2020 – pensions aspects

Under the Budget 2020, many high earners will be able to save greater amounts although those with earnings over £300,000 will be able to save less.

Please see our HR Budget Briefing 2020 for more information.

IV. Climate change risk: new requirements in the Pension Schemes Bill

The Government has introduced new, potentially onerous, governance and reporting requirements relating to climate change in the Pension Schemes Bill. These would give the Government power to impose obligations on trustees to secure effective governance on the effects of climate change (both risks and opportunities). In planning for these new measures, trustees will also need to take into account statutory DWP guidance.

The Pension Schemes Bill's Parliamentary progress has stalled because of COVID-19. When it resumes, regulations are likely to set out obligations, on both DB and DC schemes, to:

- review the exposure of the scheme to risks;
- assess scheme assets and develop a strategy for managing risk;
- measure performance against targets; and
- publish information on the effects of climate change on the scheme.

Failure to comply could result in the Pensions Regulator issuing compliance notices or fines.

The Government says that the new proposals are not intended to direct pension schemes how they should invest. They are designed to implement the Government's commitment, announced in 2019 as part of its Green Finance Strategy, to require large asset owners to make climate change disclosures in line with the recommendations of the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD). The Government says it will consult extensively before making regulations and there will be statutory guidance on how trustees should manage risk and make disclosures.

Meanwhile, the Regulator has confirmed it will be following up on trustee failures, highlighted by a recent review by the finance industry body UK Sustainable Investment and Finance, to comply with the requirements on environmental, social and governance content in Statements of Investment Principles.

V. GMP equalisation

HMRC tax guidance was issued on 20 February 2020 on equalising for the effects of GMPs on members benefits. The guidance provides some re-assurance in relation to "dual records" methods of equalising benefits, which should assist in moving forward with GMP equalisation if one of those methods is chosen. However, schemes interested in GMP conversion are likely to want to wait for further clarification from HMRC, since the guidance does not cover GMP conversion, but HMRC notes that conversion can result in tax consequences such as the loss of fixed protection or the deferred member carve-out.

HMRC's guidance newsletter on GMP equalisation covers benefit adjustments where a dual record keeping approach is adopted to equalise benefits for the period 17 May 1990 to 5 April 1997. It does not cover any other benefit adjustments made at the same time or matters such as death benefits and lump sums (where further guidance is expected "as soon as possible") or the conversion method (where HMRC "continue to explore the tax implications" but note that there can be tax consequences such as the loss of fixed protection or the deferred member carve-out or both).

Where the dual records methods are used, deferred members who do not currently have an annual allowance input (because they became deferred before 6 April 2006, or benefit from the deferred member carve-out (DMCO)), should continue with that status. Past annual allowance calculations for actives and deferred members do not need to be revisited. However, the equalisation adjustment should be reflected in the calculations for the pension input period of equalisation and subsequent periods. HMRC also confirms that fixed protections should be retained. However, HMRC note that, as this is a complex area, some individuals may need to be considered on a case-by-case basis.

Where pensions have already come into payment, HMRC states that the original lifetime allowance calculations require correction to reflect the increased starting pension. This will require practical risk based approaches to be developed, and it is hoped that the work being done by the PASA chaired GMP Equalisation Working Group will explore this.

VI. Increasing the general PPF levy: DWP response to consultation

Levy rates will increase from April 2020 and there will be a wider review of the levy.

In October 2019, the DWP published consultation on the general levy on pension schemes, in the light of a projected deficit of over £50 million for 2020/21. The consultation asked for views on options for the 2020/21 levy year. The Government has now responded to the consultation, confirming its decision to go ahead with its preferred option - to increase levy rates by 10% on 1 April 2020, with further increases from April 2021 informed by a wider review of the levy. The economic fallout arising from COVID-19 may impact this review.

In our February Bulletin, we mentioned the proposed changes in the PPF insolvency risk methodology. The PPF has now confirmed that it will go ahead with the proposals. The first levy invoices to be calculated using the new Dun & Bradstreet methodology will be issued in Autumn 2021.

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