SLAUGHTER AND MAY

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COVID-19: PENSIONS BULLETIN

March 2020

The Pensions Regulator ("TPR") has issued three further announcements on 27 March 2020, building on earlier announcements from 20 March 2020. TPR recognises the lack of visibility over the short term on funding, investment and covenant. The announcements introduce new easements, which will initially remain in place until 30 June 2020, directed at trustees and employers of defined benefit schemes and trustees of defined contribution schemes. TPR will adopt a "reasonable, pragmatic and proportionate" approach to regulation; which somewhat contrasts with its recently adopted mantra of being "clearer, quicker and tougher".

In this bulletin we consider the TPR announcements, 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.

Section A: DB scheme funding

Suspension or reduction of DRCs

TPR is of the view that trustees should be open to requests from sponsors to suspend or reduce deficit repair contributions ("DRCs") over the next three months, particularly where it is difficult currently to provide any accurate forecasting of the employer covenant. Agreement to reduce or suspend contributions comes with a number of conditions:

- Sponsors should agree to provide full and ongoing information to trustees;
- Trustees must think very carefully about delaying one-off annual contributions, or bullet payments, and the eventual repayment of the reduced or suspended contributions should be accommodated within the period covered by the scheme's current recovery plan;
- Trustees must be treated fairly with other stakeholders, and should receive legally binding undertakings that no dividend or shareholder distributions will now be paid and that banks are supportive of the business. Where the employer's lenders are willing to agree support for longer than three months, it may be appropriate for trustees to agree support of the same duration to provide stability. However, it is unlikely to be in the best interests of members for trustees to be persuaded agree to release any existing security; and
- Where the sponsor needs to make inter-company loans this should clearly be for the purposes of liquidity or ensuring the group continues to be able to trade (and not for other reasons). If amounts are not recoverable or readily available to meet scheme funding requirements, TPR expects trustees to obtain appropriate mitigation.

Trustees should take legal and actuarial advice not only on whether a suspension or reduction of DRCs is appropriate, but also on the most appropriate method to suspend or reduce DRCs (e.g. amendment of Schedule of Contributions ("SOC") or short-term suspension of payments without amendment to the SOC). This is to avoid unintended consequences such as missed payments accidentally triggering scheme wind-up.

For those trustees of schemes where a DB employer is at risk, TPR has issued a separate announcement on corporate distress.

Comments: Employers are required by legislation to pay deficit contributions in accordance with the scheme's SOC. Any failure to pay contributions under the SOC triggers a statutory debt payable to the trustees of a pension scheme and, if the failure to pay is likely to be of material significance to the exercise of any of TPR's functions, is reportable to TPR.

However, broadly, scheme funding legislation allows employers and trustees to agree to amend the SOC to reduce or suspend contributions without the need to call a further formal actuarial valuation. Some key considerations follow below.

(It should be noted that the position for some schemes may be different; for example, depending on the scheme's governing documentation, the trustees may only be required to consult with the employer, rather than reach agreement.)

First, the trustees must conclude that there are reasons that may justify a variation to the scheme's recovery plan. The trustees must consider whether such a suspension or reduction is consistent with their fiduciary duties, particularly if the employer is not willing to provide any mitigation. Just because trustees have power to reduce or suspend contributions, they must consider whether this is consistent with their duties to members. Given the easements offered by TPR, there is strong support for taking such action, but trustees will need to consider this carefully, taking account of appropriate advice and the conditions outlined by TPR. Key considerations are that trustees are treated fairly as compared with other stakeholders, and what security or other mechanism is the employer offering to protect the trustees (and members) from "regret risk" in agreeing to the variation.

The employer, in making a request for a reduction or suspension in DRCs, should also consider the statutory provisions in sections 38 to 42 of the Pensions Act 2004 (contributions notices), in order to minimise the risk of TPR potential actions against directors for pressing the trustees into accommodating a reduction or suspension of contributions.

If the trustees, having taken advice from their covenant, actuarial and legal advisers, are able to conclude that such a change is appropriate, the SOC must then be revised. Further, assuming the scheme had a technical provisions deficit at its last triennial valuation, trustees must obtain actuarial certification that the scheme's statutory funding objective can be expected to be met by the end of the period specified in the recovery plan (and is consistent with the scheme's statement of funding principles).

In addition to the statutory funding requirements, trustees and employers will need to consider any specific funding requirements in their schemes' governing documentation and any contractual agreements reached with employers on scheme funding.

TPR provides that the trustees could agree temporarily not to pursue the employer for non-payment or reduced payment of contributions. Employers may not feel comfortable relying on informal waivers from trustees and are likely to require formal agreement from the trustees. As TPR highlights there may be serious consequences under the scheme's governing documentation for failure to pay contributions, including the potential trigger of a winding-up.

As well as the scheme's governing documentation, employers and trustees will need to consider funding agreements and security documentation in place with trustees to consider what changes may be needed. Trustee boards will need to take covenant and legal advice, and need to bear in mind TPR's comments about equality with other stakeholders and legally binding commitments for employers not to pay dividend or other shareholder distributions.

Suspending or reducing future service contributions

TPR considers that many of the same requirements apply as is the case for DRCs. However, it is unlikely to be possible simply to pause future accrual for a period. Also trustees should note that there are some additional issues to consider, including (a) the need to consider member contribution rates in scheme rules and (b) in multi-employer schemes the risk of accidentally triggering wind-up or an employer cessation event.

Comments: We agree that temporarily suspending future accrual is likely to be difficult to achieve in practice, although perhaps technically possible under schemes' governing provisions.

It should be possible to amend the scheme's SOC in a similar way to that described above in relation to DRCs. However, trustees will be concerned to ensure that any employer contributions are recovered as soon as possible.

We agree that most scheme rules would need amending to reflect the fact that member contributions would cease temporarily, and that employers will need to take care not inadvertently to trigger a wind-up or employment cessation event.

The position if the scheme is close to finalising its scheme valuation

TPR provides that for those schemes close to agreeing their technical provisions as part of a current valuation process, TPR will "not necessarily" expect trustees to revisit assumptions, although some trustees may be advised that it is in the best interests of their members to do so. Further, TPR does not expect trustees to allow for relevant experience since the effective date of the valuation in their recovery plan. However, TPR does expect trustees to consider post-valuation experience when agreeing the recovery plan in the context that the employer's affordability may now be constrained.

TPR is more relaxed about trustees taking more time to conclude their valuation. A further three month delay after the 15 month period for agreeing the valuation may be appropriate. Whilst TPR cannot waive trustees' statutory obligations they do not intend to fine the trustees for late submission.

Keeping TPR up to date with developments

For those schemes subject to relationship-managed supervision, we are aware that TPR is likely already to have contacted the schemes requesting information on what steps the trustees have *taken. For all other schemes, TPR provides that they will continue to take a risk-based approach in their supervisory activity, reviewing and assessing incoming requests against a range of risk indicators.*

Comments: Given the approach TPR has already taken for those schemes subject to relationship-managed supervision, it is important that trustee boards convene as soon as possible to consider the impact of COVID-19 with their advisers.

For employers, a fall in funding does not trigger an employer notifiable event, although a breach of banking covenants (that have not been agreed with the banks) may be notifiable.

Employers should note that TPR strongly recommends that employers document their position regarding the treatment of their schemes, particularly as this may assist in any future engagement with TPR.

Section B: Investments

TPR recognises the impact of falling investments on schemes and sets out a number of explicit recommendations for trustees to consider. This includes for DB schemes the cash flow implications of any reduction or suspension of contributions; revisiting any rebalancing requirements; considering any existing hedging and collateral positions, and counterparty risk; and focussing on diversification and concentrations of risks to specific investments or sectors. TPR points out that current market dislocation also offers investment opportunities for trustees to consider. Finally, trustees should consider the terms of reference of their subcommittees to ensure they can continue to function with appropriate sign-offs.

For DC schemes, the main concern TPR highlights is the risk that members may react badly to current falls in fund values. The concern is that they may crystallise heavy losses or be exploited by pension scammers. TPR is particularly concerned that members may choose to opt out of pension savings. TPR therefore appears keen for trustees to communicate to members encouraging members to think carefully, emphasising the long-term nature of pensions savings. TPR also suggests trustees consider whether automatic switches as part of lifestyle default funds remain appropriate. Other considerations are similar for DB schemes.

Comments: Trustees of DB schemes will need to consider with their investment advisers how best to respond to current circumstances. On a more practical level trustee boards will want to consider the continued effectiveness of their current governance functions, and we consider this further in the administration section below (see Section E).

For DC schemes there is a steer from TPR that carefully worded communications with members would be appropriate at the current time, highlighting the risks in particular of crystallising significant losses or falling victim to pension scams.

Section C: Transfer requests

TPR recognises that trustees may decide (a) to suspend cash equivalent transfer value (CETV) quotations and (b) to stop transfer payments. This is because trustees may need to give themselves time to review CETV terms and/or to assess the administrative impact of any increase *in demand for CETV quotes. Administrators need to focus on the essential business of the scheme, to continue to make timely payment of benefits.*

The disclosure requirements may be breached. By way of easement, TPR agrees not to take action in the next three months against those trustees who suspend CETV activity. The Pensions Ombudsman will take TPR's guidance, and the impact of the coronavirus generally, into account when determining whether trustees took reasonable action.

If, at the end of the three-month period, trustees feel it is still in the best interests of their members to continue with the CETV suspension or delayed quotation, they should notify TPR. Trustees should, however, be clear about their reasons for the continued suspension or delayed quotation. These reasons may include continuing significant financial market uncertainty, lack of liquidity or administrative constraints.

Comments: Anecdotally, there has been an increase in requests for CETVs. Members may be concerned about the continued solvency of their scheme sponsor, and a drop in gilt yields has meant an increase in the amount of CETVs for many schemes.

Trustees may consider that a change to transfer value factors is necessary given a marked change to economic and market conditions. The schemes' transfer factors are determined by the trustees having taken actuarial advice, assessed as a best estimate of the cost of benefits. The schemes' governing documentation may also contain specific requirements to consider.

Trustees can commission an "insufficiency report" from the scheme actuary that would allow for a reduction in CETVs (both for new and existing quotes), provided that the regulatory requirements for such a report are met. Trustees should speak to the scheme actuary in the first instance.

Trustees may also wish to review the terms they offer for other benefit options such as cash commutation at retirement and early retirement terms, but the terms of the schemes' governing documentation need to be considered in each case.

Section D: PPF contingent assets

The Board of the Pension Protection Fund has published guidance on the impact of COVID-19. It says that, to the extent that there are known or estimated impacts on the scheme that can be estimated, these should be taken into account in PPF assessments. But there is no need to make any allowance for the prevailing general uncertainty. And there is no need to revisit assessments already finalised to take account of factors emerging after they were signed off. Reports should indicate what assumptions have been made, rather than seeking to exclude consideration of COVID-19.

The PPF is not permitted formally to approve extensions in advance. But it has said that, if documents are submitted after the deadline, it will consider any extenuating circumstances, such as that individuals are unwell or self-isolating. If it judges them reasonable it will accept them. Reasons need to be given at the time of late submission.

Comments: It will have come as some relief to trustees and employers that trustees are not required to revisit reports already submitted. However, it should be noted that the examples of easement offered by the PPF for late submission of contingent asset certificate are limited to where individuals are unwell or self-isolating. They do not, for example, cover any delay as a result of genuine lack of management time to complete the relevant formalities of a PPF contingent asset. This would need to be argued on a case-by-case basis.

Section E: Administration issues

Continued effectiveness of the Trustee Board

In its 20 March 2020 announcement, TPR requires trustees to assess whether their business continuity plan (BCP) is still adequate and to contact scheme administrators to find out what contingency is in place to mitigate their impact of increases in work volumes or unavailable staff.

TPR recommends trustees prioritise certain activities, in the event of under-resourcing, such as pensioner payments, retirement processing and bereavement payments.

Comments: There are a number of considerations for trustees:

- **Special trustee meeting:** TPR are contacting trustee board to enquire what their COVID-19 governance steps are. It would be prudent to examine these at a (special) trustee boards meeting as soon as possible and document them.
- **Additional resources:** Trustees will need to consider what resources are needed to allow the scheme manager and secretary to continue to provide services to the trustee board, as well as any contingency plans if the pensions manager or scheme secretary is unable to work.
- **How will the trustee board function if members are incapacitated by COVID-19:** Trustees should consider further flexibility for the full board and its sub-committees. This may include (a) increased delegation of authority to one or more of its sub-committees, including the option of an emergency sub-committee to deal with coronavirus; (b) amending minimum requirements for the quorum for the holding of meeting or voting rights; and (c) greater flexibility to change the chair at meetings.

  Trustees should take advice on the requirements in the trustee company's articles of association or, in the case of individual trustees, the governing trust deed and rules, for holding trustee meetings by conference call and/or video link, as well as the terms of reference for each of its sub-committee.

- **Administration services:** Trustees will need to consider what potential impact there may be on continued administrative services to the pension scheme. The BCPs for the scheme administrator, and other key suppliers, should be obtained, and the trustees should confirm in each case that the plans remain actionable.

  The trustees need to assess the risk that current service levels cannot be maintained in the coming months, and how core administration activities can, if needed, be prioritised. Priority should rightly be given to the payments of benefits, retirement processing and bereavement services, as well as any administrative functions required to support these. After this administrators should focus on the processes needed to ensure accurate benefits (e.g. investment of contributions).

Where significant projects are being undertaken by the scheme, trustees may wish to consider whether the projects can continue as planned or if resources may have to be deployed by the administrator elsewhere.

If administrators have failed to meet service levels (SLAs) in administration contracts, they may seek to invoke special clauses in contracts, such as force majeure provisions, in order to limit their liability. The scope and application of these clauses is a complicated area and specific legal advice should be taken.

- **Reporting breaches:** TPR would like reports to continue to be made as normal where there has been a breach of statutory requirements. As noted elsewhere, TPR will adopt a pragmatic approach where there have been breaches of statutory requirements. However, TPR has said that trustees should report immediately if they believe they will be unable to pay members' benefits.
- **Execution of agreements:** It is likely to be possible for schemes to make use of electronic signature software, such as DocuSign, for the remote execution of contracts. Legal advice should be sought on the effectiveness of this software to authenticate contracts. Whilst the law has developed sufficient flexibility to allow for the use of electronic signatures, particular care should be taken in relation to the execution of deeds where the signature of an individual needs be witnessed.

Section F: CJRS and EML

Coronavirus Job Retention Scheme (CJRS)

The CJRS is a temporary scheme open to all UK employers for at least three months starting from 1 March 2020. Operated by HM Revenue & Customs, it is designed to support employers whose operations have been severely affected by COVID-19. More details were released on 26 March 2020: see link. Please also see attached a link to our employment law briefing.

Furloughed employees must have been on PAYE payroll on 28 February 2020, and can be on any type of contract, including: full-time and part-time employees; employees on agency contracts; and employees on flexible or zero-hour contract. The CJRS also covers employees who were made redundant since 28 February 2020, if they are rehired by their employer. However, if an employee is working, but on reduced hours, or for reduced pay, they will not be eligible.

Employers can use a portal to claim for 80% of furloughed employees' (employees on a leave of absence) usual monthly wage costs, up to £2,500 a month, plus the associated Employer National Insurance contributions and minimum automatic enrolment employer pension contributions on that subsidised wage. Fees, commission and bonuses are not included. Employer National Insurance Contributions and automatic enrolment contribution on any additional top-up salary will not be funded through the CJRS. Nor will any voluntary automatic enrolment contributions above the minimum mandatory employer contribution of 3% of income above the lower limit of qualifying earnings (which is £512 per month until 5th April and will be £520 per month from 6th April 2020 onwards).

Comments: Some open questions remain from the proposals on the impact of pension provision:

- How the proposal impacts on the accrual of benefits and contributions in an open scheme, if an employee is furloughed and on reduced pay. The specific rules governing the scheme will need to be checked.
- The impact on those employers who make automatic enrolment contributions assessed by reference to basic salary rather than minimum qualifying earnings.
- For those members who have agreed salary sacrifice arrangements with their employers, the CJRS will it seems only provide compensation on the basis of the reduced salary agreed as part of salary sacrifice. The government has not indicated that any additional compensation will be payable to address the fact that such members will be in a worse position than an identical member who has not opted for salary sacrifice. It is also unlikely to be possible to amend existing salary sacrifice arrangements retrospectively to change the position.

Emergency Volunteer leave (EVL)

The Coronavirus Act 2020 contains provisions allowing workers to take periods of emergency volunteering leave for periods of 2, 3 or 4 consecutive weeks. The leave is unpaid.

During such leave, the worker has to be treated both in relation to membership of, and accrual of benefits under their pension scheme, as if he were not on leave. But employee contributions must be based on the amount the worker is actually paid during the leave.

Comments: The provisions in the 2020 Act are based on the existing pension requirements for periods of maternity leave. For DC schemes, employers are required to pay employer contributions based on what the worker would have been paid had he not taken leave. The legislation is unclear if the employer also has to top up employee contributions to the same extent, given that the worker has only to make contributions on any actual pay received and legal advice should be taken. It will be important to consider the absence provisions in the scheme’s governing documentation.

If you would like further information about the impact of COVID-19 on your business, please speak to your usual Slaughter and May contact.

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