PENSIONS NEWS

NOVEMBER 2013

IN THIS ISSUE

INTRODUCTION

Welcome to DLA Piper's Pensions News publication in which we report on recent developments in pensions legislation, guidance and case law, as well as keeping you up to speed on what to look out for in the coming months.

This edition brings you the developments from November 2013 including the following.

- **Automatic enrolment:** an update from the Regulator on business sector compliance visits that it has completed; a report from the DWP on the results of research evaluating the reforms; and updated versions of the Regulator's detailed guidance.
- **The Pensions Regulator:** guidance for trustees and their advisers on asset-backed contributions; the coming into force of the DC Code and the publication of accompanying guidance and the final form of the compliance and enforcement policy in respect of trust-based occupational DC schemes; and the results of research on the Regulator's May 2013 annual funding statement.
- **DWP:** a consultation exploring proposals for defined ambition schemes; a summary of the results of research on annual management charges in DC schemes; and a consultation on miscellaneous amendment regulations to simplify some administrative provisions of the legislation.
- **Case law:** a judgment of the Court of Appeal in Northern Ireland relating to contribution notices and time limits.
- **Other news:** an update on the new Fair Deal policy; the annual revaluation order; and a consultation on amendments to guidance on Statutory Money Purchase Illustrations to bring it into line with the new disclosure regulations.

If you would like to know more about any of the items featured in this edition of Pensions News or how they might affect you, please get in touch with your usual DLA Piper pensions contact or contact Cathryn Everest. Contact details can be found on page 25.

AUTOMATIC ENROLMENT

COMPLIANCE VISITS BY THE REGULATOR

On 19 November the Pensions Regulator issued a press release announcing that it had carried out the first in a series of "*in depth fact finding visits*" to business sectors that may face challenges with automatic enrolment compliance.

The Regulator states that this marks the launch of a proactive drive towards different sectors and demonstrates how direct intervention will be used to ensure compliance and to help establish a pro compliance culture.

The recruitment sector was the subject of this first series of visits and the Regulator explains that it was identified through its intelligence work in line with its compliance and enforcement proportionality framework. This sector faces particular challenges due to an atypical workforce and the Regulator states that it was important to focus on it because more than 1,000 recruitment employers are due to reach their staging date between April and July 2014.

The visits to a number of recruitment employers allowed the Regulator's automatic enrolment compliance and enforcement team to have an in-depth look at how these employers are implementing automatic enrolment and to gain a good understanding of the issues faced by the sector. As a result of information gathered, the Regulator will be issuing compliance guidance tailored for the recruitment sector.

Looking ahead, in the coming months the Regulator will be carrying out visits to employers in other sectors where compliance challenges have been identified to ensure any problems faced are addressed in good time and that they do not risk non-compliance.

The Regulator also took the opportunity in the press release to remind employers of the importance of early preparation for the reforms which it recommends is started 12 to 18 months ahead of the employer's staging date.

EVALUATION REPORT

On 28 November, the DWP published "*Automatic Enrolment evaluation report 2013*" a report which it is using to understand the impact of the reforms so far and to inform future improvements to ensure automatic enrolment is working as intended.

In July 2011 the DWP set out its evaluation strategy which involves looking at issues such as: whether the reforms are delivered to the planned timescales; whether employers know about, understand and comply with their duties; the extent to which the reforms increase the number of individuals saving in workplace pensions; and the extent to which delivery is achieved with a minimal burden on employers.

Findings reported include the following.

- Up to the end of October 2013, more than 1.9 million workers had been automatically enrolled across nearly 3,000 employers.
- The results of the DWP's research with large employers with staging dates between October 2012 and April 2013 which showed an average opt out rate of 9%. (Further details on this research were reported in the August edition of Pensions News.)
- Research with large employers found that most were satisfied that their communications had successfully informed workers about automatic enrolment and volumes of queries from workers were much lower than employers expected.
- Looking at levels of awareness among employers four months prior to staging, the results of research by the Regulator showed that all employers staging between October 2012 and April 2013 and 99% of those due to stage between May 2013 and October 2013 were aware of the reforms. The levels were also very high for those staging in November 2013 and January 2014. (There is no staging date in December 2013.)
- Most employers understood their automatic enrolment duties although levels of understanding have decreased slightly over time.

- The key implementation challenges identified by large employers were establishing effective data systems, categorising and assessing workers and communicating the changes to workers. The DWP notes here the recent amendments to the legislation made in response to these issues which aim to make the automatic enrolment process more straightforward.
- Between 2010 and 2012 before the introduction of automatic enrolment, around 6% of eligible savers experienced some form of 'levelling down' (that is, a reduction of contributions or outcomes for members).
- Recent DWP analysis has shown that automatic enrolment is expected to halve the number of people retiring with no pension provision at all from 27% to 12% in 2050.

The DWP states that future evaluation reports will be published on an annual basis.

PENSIONS REGULATOR'S GUIDANCE

Updates to reflect changes in law and guidance

In the October edition of Pensions News, we reported on technical amendments to the legislation on automatic enrolment, the majority of which came into force on 1 November 2013, others of which will come into force on 1 April 2014.

In November, the Pensions Regulator updated its detailed guidance on automatic enrolment to reflect the changes to the legislation including to update existing examples on assessing the workforce for jobholder status to add corresponding examples for employers using the new definition of pay reference periods which are aligned with tax periods.

Other updates to the guidance to reflect developments since the last versions were published include amendments:

- to make it consistent with the provisions of the Pensions Bill which clarify that the transitional period for DB and hybrid schemes can only be used in respect of employees entitled to defined benefits;
- to reflect the ban on member-borne consultancy charges in DC automatic enrolment schemes; and
- to make it consistent with the revised Codes of Practice and guidance on maintaining contributions.

New volumes

Two new volumes of guidance have also now been added – one entitled "*Information to workers*" which was previously available as a resource but has been updated and now forms part of the guidance and one entitled "*Automatic re-enrolment: Putting members back into pension scheme membership*".

Other updates

At the same time that the updating amendments were made, further clarification was added to the guidance on certain points including the following.

- Assessing the workforce
  - A non-exhaustive list of factors that can be taken into account when assessing whether multiple contracts between an employer and a worker should be treated as one single contract – independence of the contracts, the type of work and benefits under the contracts. The guidance also states that if the employer has determined (as opposed to simply having adopted an administrative process) that for the purposes of employment rights the multiple contracts operate as one, the Regulator's view is that it would be reasonable to arrive at the same conclusion in relation to automatic enrolment.
  - The guidance now notes that employers must ensure that they cleanse and update their worker records in preparation for the duties because, for example, they will need up to date earnings and age information to assess whether the worker is eligible for automatic enrolment.
  - The guidance now confirms that where a change to the earnings thresholds with effect from 6 April occurs during a pay reference period, the employer

should check what date is the assessment date. If it is prior to 6 April, the existing threshold should be applied and if it is on or after 6 April, the updated threshold should be applied.

- Workers who invoice for services rather than being paid via payroll
  - The guidance states that in these cases the same principle of identifying the period by reference to which the worker is paid applies. For example, if invoices are collated over defined periods of time, such as on a weekly basis, this is the period of time by reference to which the employer pays the person. Or, if a person will be paid a fixed fee at the end of a contract, the contract duration is the pay reference period.
- 'Giving' information to a worker
  - Throughout the guidance, references to information being 'provided' or 'issued' have been changed to information being 'given' and further guidance has been added about 'giving' information, including the following points.
  - The Regulator's view is that 'giving' information includes: sending hard copy information by post or internal mail; handing over hard copy information by hand; sending information in the body of an e-mail; and sending information in pdf attachments or other attachments by e-mail.
  - As noted in the previous versions, the guidance states that this does not include merely signposting to an internet or intranet site or displaying a poster in the workplace. It now also says that it does not include attaching a URL. The Regulator comments that these methods merely amount to providing access to information, not giving the actual information.
  - The guidance also states that when information is being given to a worker by post, the employer should allow sufficient time for the delivery of the letter in the ordinary course of post, in order that the information can be given before the end of the specified time limit. However, when information is given by hand or electronically, receipt is likely to be instant.
  - In deciding on the method of giving information, an employer should consider the appropriateness of the format for their workers, for example, the extent to which electronic access is available.
  - Employers should consider the completeness and accuracy of the data they are using for giving the information, for example, if post is returned as 'gone away' or email bounces back, the employer cannot be considered to have given the information to the worker.
- Combining different information requirements
  - The Regulator's view is that employers considering whether to combine a number of the information requirements into one communication or issue separate communications (for example, as part of choosing the form of postponement notice) should think about the appropriateness of their preferred approach for their workforce. This will include a judgement about the ability of the workforce to absorb the level of detail all in one go and a judgement about the relevance of the information to the worker.

Each volume of the guidance contains an appendix summarising the changes made since the previous version.

THE PENSIONS REGULATOR

GUIDANCE ON ASSET-BACKED CONTRIBUTIONS

Background

What are asset-backed contributions?

The use of asset-backed contributions (**"ABCs"**) has been gaining increasing popularity in recent years as a means for employers to meet their funding obligations. ABCs involve a scheme employer utilising assets held in its group to generate an income stream which is paid to the scheme over an extended period. This enables the employer to keep control of the assets and the scheme deficit to be reduced by the capitalised value of the income stream. Real estate is an asset that is commonly used but arrangements that have been put in place have involved a wide range of assets including intellectual property, financial instruments, barrels of whisky and maturing cheese.

By way of example, a typical structure using real estate as the relevant asset involves the following.

- The trustee invests in a Special Purpose Vehicle (SPV) which is a Scottish Limited Partnership, with this investment being funded by a one off contribution to the scheme from the scheme employer. The reason for using a Scottish Limited Partnership is that this structure is believed to prevent a breach of restrictions on employer-related investments (ERI).
- The SPV uses the investment to purchase a property portfolio from the employer group.
- The properties are leased back to the employer group by the SPV for the term of the arrangement.
- The rent is paid to the SPV and then it (or a set amount of it) is used to provide a defined income stream to the scheme for the term of the arrangement which could be a period of up to 25 years.
- The employer is able to continue to use and have control over the assets held in the SPV but the trustee will have access to the assets in the event of the employer's insolvency.

The Regulator's November 2010 Statement

In November 2010 the Regulator issued a Statement on ERI within which it noted that there had been an increase in the use of mechanisms that do not involve only direct and unconditional cash payments from scheme employers and that the Regulator's view was that some of these mechanisms (including some limited partnership structures) could potentially carry a risk of ERI breach. The Statement went on to say that:

- where trustees agree to the use of such a mechanism and, in the absence of a court decision confirming it does not involve ERI breaches, the Regulator expects them to recognise the risk of the mechanism being held to be void for illegality in the future;
- if this risk could impact on the scheme, the Regulator expects the agreement to include an 'underpin' which would provide an alternative funding structure, for example, straightforward cash contributions;
- the Regulator expects to be informed about these funding mechanisms;
- the Regulator expects details of the funding mechanism to be communicated to members in a clear and transparent manner, for example, in the summary funding statement; and
- trustees should ensure the assets supporting the funding mechanisms are independently valued.

The Regulator's November 2013 guidance

On 19 November 2013 the Regulator published guidance specifically setting out its expectations of trustees when considering ABCs which is said to expand on the November 2010 Statement and be based on the Regulator's recent experience in relation to ABCs.

Risks in relation to ABCs

The guidance sets out the following six key risks that trustees should consider as part of their assessment of any ABC proposal.

- *Inflexible schedule of payments, delaying full funding.* Points noted in the guidance include the following:
  - ABCs can involve long payment periods which could mean the scheme receives lower annual payments than under an appropriate recovery plan with the risk that the scheme will be underfunded if the ABC fails in the short to medium term, which may not be mitigated by the presence of the asset in the ABC;
  - ABCs sometimes fetter the trustees' discretion to agree higher recovery payments by locking them into a fixed payment stream; and
  - the scheme remains exposed to any downturn in the sponsoring employer's fortunes, for example, if the value of the asset is intrinsically linked to the employer's health.
- *Weak underlying assets or limited legal claims on those assets.* Points here include that:
  - it is important to note that the trustees do not own the underlying asset and the level of reliance that can be placed on the interest in the ABC depends on the value of the asset itself and the extent to which trustees have claims to it;
  - trustees must consider both the present value of the underlying asset and the value of it on the insolvency of the sponsoring employer/group including whether the speed of realisation could impact on this; and
  - in terms of the extent of the trustees' legal claim on the assets, information is given on what the position may be if there are no 'step-in' rights for the trustees.
- *Masking the scheme's overall risk profile.* This relates to the fact that whilst the future income stream is capitalised and treated as an asset which leads to an immediate improvement to the scheme's funding level, the scheme in fact remains reliant on the sponsoring employer and/or ABC being able to make future payments.
- *Weakened covenant.* The Regulator states that in some circumstances, the establishment or ongoing operation of the ABC could damage the employer covenant. For example, if the trustees already have access to the asset via security granted over it and the access is reduced by the asset being transferred to an ABC.
- *Illegality of the structure.* This relates to the ERI risk highlighted in the November 2010 Statement. The Regulator notes that the view that ABCs are a 'loophole' in the ERI restrictions remains untested by the courts.
- *Costs and complexity.*

The Regulator's expectation of trustees

The Regulator's expectations of trustees include the following.

- They should properly understand the risks and benefits of any proposals for ABCs by undertaking a robust evaluation of the ABC.
- They will need to take investment advice and will generally need to obtain extensive legal, actuarial, asset valuation and covenant advice with the guidance setting out issues the Regulator expects the advice to cover.
- They should consider all feasible options and decide whether any advantages to the scheme of entering the ABC could be obtained through another arrangement which does not carry the same restrictions.
- An underpin should be in place to protect the scheme's position (for example, should the courts find that ABCs are void for illegality). There is now more detail about the requirements for underpins than in the November 2010 Statement including that: (i) the underpin should be in a separate arrangement; (ii) it should cover any repayment to the scheme of monies already received under the ABC but returned as well as future payments; and (iii) it should not simply take the form of an agreement to agree an alternative funding plan. Where an existing ABC arrangement does not contain an adequate underpin the Regulator expects this to be rectified as soon as practicably possible.

- Trustees should "*unpack*" the ABC arrangement by disregarding the net present value attributed to it in the scheme accounts and instead looking at it as a funding stream, which will enable them to identify the extent to which the scheme's future funding flow depends on payments from the ABC, the period over which they will be made and whether they are back-end loaded.
- They should explain the decision to the members in the next available communication and should report any investment in an ABC to the Regulator.

The Regulator's approach

The Regulator states that:

- where appropriate, it will challenge trustees' decisions to enter into ABC arrangements;
- in keeping with its general approach, it will operate in a risk-based and proportionate manner and will consider the effect of ABCs on a case-by-case basis;
- if it has concerns about ABCs, it may consider its full range of powers as appropriate; and
- when considering an actuarial valuation, where the valuation of the payment stream under the ABC is material, the Regulator will "*unpack*" the effect of the ABC. If the payment period is longer or more back-end loaded than a recovery plan, it will ask trustees to explain how they have concluded this is justified by the value of and access to the underlying asset. Trustees should be able to demonstrate how they have concluded that entering into the arrangement is in the best interests of beneficiaries.

DC REGULATION – OCCUPATIONAL TRUST-BASED SCHEMES

On 21 November the Pensions Regulator published various documents in relation to DC regulation.

DC Code

The final form of "*Code of practice no 13 Governance and administration of occupational defined contribution trust-based pension schemes*" (**"DC Code"**) was published and came into force on 21 November.

As we reported in the July edition of Pensions News (when the DC Code was laid before Parliament), the DC Code:

- provides a central point of reference for areas of governance relevant to the DC quality features underlying the Regulator's six DC principles and complements and builds on (rather than replaces) other Codes and guidance; and
- is divided into five sections: know your scheme; risk management; investment; governance of conflicts of interest and advisers/service providers; and administration.

The DC Code sets out legal requirements and practical guidance. The Regulator states that trustees may not need to follow all the practical guidance in every circumstance and may be able to use alternative actions or approaches to meet their legal obligations.

DC regulatory guidance

The final form of accompanying regulatory guidance was also published. The Regulator states that whilst the DC Code focuses on the DC quality features relating to the requirements of pensions legislation, the regulatory guidance covers those features that reflect the Regulator's view of good practice.

As is the case for the DC Code, the Regulator suggests that trustees work through each section of the guidance systematically and notes that they could prioritise the sections and work through the detail on a modular basis.

The DC regulatory guidance addresses the following areas.

Investment which focuses on communicating with members about investment choices. This covers some general points about communications (for example, ensuring the names of funds are clear and the risk profile of the funds is described to make it easy for members to understand) as well as specific points about standard communications and those sent out in relation to scheme events.

Governance which covers: value for money; transparency of costs and charges for members; transparency of costs and charges for employers; and contribution levels, including communications in relation to contributions.

In respect of value for money, the guidance states that trustees should:

- keep this in mind on an ongoing basis, including it as an item on the scheme's risk register; and
- separately, carry out a periodic strategic review (for example, every three years) following steps set out in a model process outlined in the guidance.

In the accompanying press release, the Regulator states that it regards the guidance on assessing value for money as an initial step and intends to have further discussions with the pensions sector in 2014 about how schemes can capture and report their value for money information.

Administration which focuses on establishing a robust retirement process covering: what the retirement process should achieve; legal requirements (including the open market option, disclosure requirements, record-keeping requirements and internal controls); the importance of good quality data; the design of the retirement process; enabling member retirement decisions; and supporting members' retirement decisions. This section also sets out a model retirement process.

In the section on supporting members' retirement decisions, the guidance states that, where possible, trustees should provide a facilitated process, liaising with the employer or provider as necessary. (A facilitated process is one where the trustees and/or employer facilitate member decision making by appointing an adviser or annuity broker.)

Member communications which focuses on the DC quality feature of ensuring that scheme communication is accurate, clear, understandable and engaging and addresses the needs of members from joining to retirement. The key legal requirements (for example, the provisions of the disclosure regulations that require certain information to be provided when a person joins a scheme) are set out.

This is followed by practical guidance that covers issues such as: working with the employer; accurate, clear and understandable and engaging communications; providing the right information; the timing and channel of communications; monitoring effectiveness and ensuring that quality of communications is an item in the scheme's risk register.

Introduction to the DC Code and regulatory guidance

An updated version of the introductory document was also published on 21 November. This sets out each of the 31 DC quality features and, for each one, lists example trustee tasks and where in the DC Code or guidance to find more information.

Compliance policy

In the October edition of Pensions News, we reported that the Regulator had published a draft compliance and enforcement policy in respect of occupational DC trust-based schemes for consultation.

The response to that consultation and the final form of the policy were published on 21 November.

The content of the policy is largely unchanged from the draft version although some amendments have been made with the intention of improving clarity, for example, to add a statement in the introduction to the policy which recognises that considerations may be different for AVC arrangements where members are not solely reliant on a DC pension and that trustees will need to take a pragmatic approach in such situations.

Future activity

The accompanying press release issued by the Regulator alongside all of these documents notes that from next year, the Regulator plans to undertake thematic reviews of the extent to which trust-based DC schemes are compliant with pensions legislation and associated good practice in different areas.

In its DC regulatory strategy published in October, the Regulator stated that it is asking trustees of occupational DC schemes to assess their schemes and publish governance statements explaining the extent to which the scheme has embedded the DC quality features. At that time, the Regulator stated that it would publish a template governance statement and this latest press release states this will be published in 2014.

The Regulator's press release states that, "from today", it expects DC trustees to assess their scheme against the standards set out in the DC Code. Whilst no specific timescale or deadline is mentioned, the DC quality features are reflected in the DC Code and guidance and therefore there seems to be a link here to the governance statements.

In terms of timescales in which trustees should issue their first 'comply or explain' governance statement, we noted in the October edition of Pensions News that this was not set out in the regulatory strategy but that we had asked the Regulator for confirmation on this point. The Regulator has informed us that it will publish its expectations on timing at the same time that it publishes the governance statement template in the first quarter of 2014.

Trustees of DB schemes with money purchase AVCs should bear in mind that the DC Code and regulatory guidance also apply to them, albeit that sometimes a different approach may be appropriate than that for purely DC schemes.

If you would like any trustee training on the new requirements, please get in touch with your usual DLA Piper pensions contact.

PURPLE BOOK 2013 (JOINT PUBLICATION WITH THE PPF)

The Purple Book is a joint annual publication by the Regulator and the PPF which focuses on the risks faced by DB schemes, predominantly in the private sector, with the main focus being the position at the end of March for the relevant year. The Purple Book looks at scheme demographics, scheme funding, funding sensitivities, insolvency risk, asset allocation, risk developments, levy payments, schemes in assessment, PPF compensation and risk reduction.

The Purple Book 2013 was published on 5 November 2013. It is based on information from scheme returns for a dataset of 6,150 DB schemes, covering 11.4 million memberships and representing around 99% of PPF-eligible schemes and universe liabilities. The PPF-eligible universe is estimated to be around 6,225 schemes which is a reduction from 6,460 in March 2012, reflecting schemes winding-up, mergers, transfers to the PPF and block transfers.

Findings from the Purple Book 2013 include the following.

- Scheme demographics
  - At 14%, the proportion of schemes open to new members and future accruals was broadly unchanged from 2012.

- 54% of schemes are closed to new members but open to future accrual compared to 57% for the Purple Book 2012.
- 30% of schemes are closed to future accrual compared to 26% for the Purple Book 2012.
- 2% of schemes were in winding-up.
- The largest proportions of open schemes are in the categories of those with 5,000 to 9,999 members and those with greater than 10,000 members.

■ Scheme funding and funding sensitivities

- Between 2012 and 2013, the section 179 funding ratio remained relatively stable, rising by 1% from 83% to 84%. Since the end of March 2013, aggregate scheme funding has increased from 84% to 93% in September 2013.
- The full buy out funding ratio increased by 1% since 2012 from 60% to 61%.
- Looking at the funding ratio over time, changes in market conditions and financial and demographic assumptions since January 2003 have resulted in a variation of the aggregate section 179 funding ratio of around 52 percentage points. The highest ratio was 130% in June 2007 and the lowest was 78% in May 2012.

■ Asset allocation

- The Purple Book 2013 shows a continuation of most of the trends seen in recent years. That is, a falling equity allocation (from 38.5% in 2012 to 35.1%) and a rising proportion in bonds, hedge funds and cash and deposits and, within equities, a rising overseas share and falling UK share.
- Within bonds, for the first time since 2008 there was a fall in the corporate bond allocation and slightly rising government bond allocation.

■ Levy payments

- The PPF levy is very small compared with the value of total stressed, smoothed assets with an average of 0.08% over the sample in 2012/13.
- The number of schemes paying no risk-based levy in 2012/13 represented 19% of schemes, which was an increase from 5% in 2011/12.

■ Risk reduction

- The total number of recognised contingent assets in place for the 2013/14 levy year was around 830 which is somewhat lower than for 2012/13. This is said to reflect a fall in the number of Type A contingent assets (company guarantees) which resulted from firmer standards of validation introduced by the PPF.
- There was a slight rise in the number of Type B contingent assets (security over cash, real estate and securities).
- By 10 April 2013, approximately £28.5 billion of Deficit Reduction Contributions had been certified to reduce deficits for the 2013/14 levy year.
- In terms of risk transfer business of buy-outs, buy-ins and longevity hedges:
  - ○ between the end of 2007 and the first quarter of 2013, this amounted to £50.5 billion; and
  - ○ over the year to Q1 2013, the total value of transfer deals was £10.3 billion.

The Purple Book contains a large amount of statistical information and analysis. Further detail on the findings in the areas set out above as well as findings in the areas of insolvency risk, risk developments, schemes in assessment and PPF compensation can be found in the full report or its Executive Summary, both of which are available on the PPF's website.

SURVEY ON ANNUAL FUNDING STATEMENT

In the May edition of Pensions News, we reported on the publication of the Regulator's second annual funding statement which was primarily aimed at those undertaking scheme valuations with effective dates in the period 22 September 2012 to 21 September 2013.

Following this, in July 2013, the Regulator conducted a quantitative survey aimed at determining the extent to which the messages in the statement had reached the intended audiences and were understood as well as ascertaining perceptions of the statement and the extent to which schemes intended to apply the flexibilities in the funding framework and produce a valuation consistent with the Regulator's expectations.

100 actuaries, 150 employers and 150 trustees formed the sample for the survey, key findings of which included the following.

Awareness

- Awareness of the statement (and therefore awareness of its key messages) was lower among trustees and employers than was the case in the survey on the 2012 statement with prompted awareness for trustees at 72% (compared to 93%) and for employers at 65% (compared to 79%).
- The majority of trustees and employers who were aware of the statement were also aware of the key messages with 63% of trustees and 50% of employers having awareness of at least six of the eight main messages. The two messages which were not as well recalled were 'TPR's views on acceptable approaches to the valuation process' and 'treating the pension scheme as equal priority with other financial demands'.
- All actuaries were aware of the statement and over 90% were aware of each of the key messages.

Understanding

- On average across the eight key messages, of those who were aware of them, 91% of employers and 96% of trustees had at least some understanding of the meaning of the messages.
- The message about 'TPR's views on acceptable approaches to the valuation process' was less well understood by trustees and employers than the other messages.

Perceptions of the statement

- 86% of trustees, 74% of employers and 82% of actuaries considered the statement to be helpful. This represented statistically significant increases for trustees and actuaries from 75% and 68% respectively in 2012.
- There was also a statistically significant increase in the proportion of actuaries who rated the statement as 'very good' or 'good' with an increase from 59% to 83%. The figures of 56% for employers and 77% for trustees were consistent with results for 2012.

Flexibilities in the funding framework

- The flexibility most likely to be used is adjusting employer contributions, which 61% of trustees and 49% of employers said they would definitely or probably use.
- 47% of employers stated that they would definitely or probably extend their recovery plan which is an increase from 33% in 2012.

TPR's new statutory objective

- When asked about new or emerging issues encountered that year that affected the timings for valuations, only two respondents (both actuaries) spontaneously mentioned the Regulator's new objective.
- Despite high levels of awareness of the Regulator's new objective, only 15% of actuaries, 4% of employers and 5% of trustees felt that the Regulator's new objective would slightly or significantly affect scheme valuation timetables.

TRUSTEE NEWSLETTER

The Pensions Regulator published "*Trustee Knowhow November 2013*", a trustee newsletter which covers the following issues.

- Pension liberation fraud with the article providing an overview of what it is, warning signs and the literature available to help educate members about this issue and noting that tools and guidance are available from the Regulator's website on this issue. The article also states that trustees should ensure that procedures are in place by whoever administers the scheme to help prevent this fraud and that the Regulator's guidance can help trustees do this.
- A reminder that trustees have to complete regular scheme returns and that the Regulator also expects schemes to update it with any significant changes (such as changes to the trustee board and contact information for trustees) at any time.
- Information about the Trustee Toolkit, the guide for new trustees published in September 2013 and guidance on reporting late contributions.
- A brief summary of the role of a trustee.
- A reminder that trustees need to be aware of the impact of automatic enrolment on existing members as well as new members who may join their scheme as a result of automatic enrolment.

PENSION PROTECTION FUND

TECHNICAL NEWS BULLETIN

On 29 November the PPF published Issue 4 of its "*Technical News*" bulletin which provides an update on topical issues and practical guidance for schemes in PPF assessment periods and FAS qualifying schemes. The items covered include the following.

- A summary of the implications of pension sharing to the PPF and any schemes in assessment. To assist with this issue, the PPF will be making changes to its Data Interface Layout guidance in 2014 which will be described in more detail in the next edition of Technical News.
- News that the Pensions Research Accountants' Group is planning to consult on revisions to the Statement of Recommended Practice on Financial Reports of Pensions Schemes in the first quarter of 2014. This will provide trustees and their accountants with guidance on the interpretation of the relevant Financial Reporting Standard applicable for pension schemes (FRS102) when preparing pension scheme accounts. It is intended that the updated Statement will apply for the first time to accounting periods beginning on 1 January 2015.
- An update on the proposed changes to the PPF compensation cap (reported in the June edition of Pensions News) for members with service in excess of 20 years. The PPF states that it expects the changes to come into force some time in 2014 and, because the application of the new cap depends on length of service, reminds trustees and administrators of the importance of correct data.
- The PPF notes the consultation issued by the DWP in October (reported in that month's edition of Pensions News) on supplementary and consequential changes to the legislation as a result of the change in the definition of money purchase benefits set out in the Pensions Act 2011 and expected to be brought into force with retrospective effect in April 2014. It states that until legislative changes are made, the PPF will continue to treat money purchase benefits under its established procedures.

DEPARTMENT FOR WORK AND PENSIONS

DEFINED AMBITION CONSULTATION

Background

In the November 2012 edition of Pensions News we reported on a DWP paper called "*Reinvigorating workplace pensions*" which set out the Government's initial considerations in the area of Defined Ambition (DA) pensions. The aim of DA pensions is to provide a middle ground which gives greater certainty for members than in a purely DC scheme but less cost volatility for employers than in current DB schemes. The proposals in November 2012 were exploratory with further work due to take place with employers, the pensions industry and consumers.

The DWP reports that over the last 12 months the DA project (which is a joint project between the DWP and the pensions industry) has been exploring options and on 7 November 2013 the DWP published a formal consultation on this issue entitled "*Reshaping workplace pensions for future generations*" which further explores some proposals for DA schemes.

Flexible DB

The DWP's research has suggested that proposals in relation to DC schemes are likely to be of interest to the majority of employers but that there are a smaller number of large employers with existing DB schemes with high levels of membership who would be interested in retaining DB provision but with less uncertainty and cost volatility.

The consultation notes that the planned abolition of contracting-out in 2016 will result in DB schemes no longer having to provide specific benefits for future accruals or rights for survivors on future accruals. It is proposed to build on this by removing the statutory requirements for the indexation of pensions in payment for future accruals. This would provide a simplified DB framework which the DA proposals build on with the following three potential designs (which are not intended to be mutually exclusive) set out in the consultation.

- An ability to pay fluctuating benefits so that employers could choose to provide additional benefits (for example, indexation) when the scheme funding position allows.
- Automatic conversion to DC when the member leaves employment before retirement. In such cases, the amount of pension accrued in the scheme would be crystallised and the cash value transferred to a nominated DC pension fund. In contrast, if a member died in service or retired, the normal scheme rules would apply.
- An ability to change scheme pension age in order that future pension provision can be based on the projected number of years in retirement and therefore take into account changes to longevity.

For each design, the consultation sets out a high level description of the type of legislative requirements that might need to be changed to facilitate them. In relation to paying fluctuating benefits and changing scheme pension age this includes that the DWP will consider whether a statutory override should be provided to enable existing schemes to change their rules more easily.

Providing greater certainty for members in the DC world

The part of the consultation on this area starts by recognising the need to be clear about what is meant by certainty – that is, does it mean hard guarantees or a target or using investment strategies to manage risk. The primary focus for DA is said to be hard guarantees and a number of models have been explored in this area which provide security against different types of risk. The models considered by the consultation are as follows and it is proposed that these would be delivered through the market.

- Model 1 – money-back guarantee intended to ensure that the amount of accumulated savings at retirement or transfer does not fall below the nominal value of contributions made to the scheme. The DWP states that its discussions suggest that model 1 is the least favoured model because of a low number of scenarios in which it could occur and because of the emphasis on the savings pot rather than the income received.

- Model 2 – capital and investment return guarantee which is said to offer guarantees at the mid-point of the pension life cycle when a member has built up a sum and their primary focus shifts to preventing loss of capital but still with a need to continue to grow the fund.
- Model 3 – retirement income insurance which is said to be intended to provide certainty about income in retirement before the member retires to address the conversion risk associated with buying an annuity and seeks to maximise the investment returns on the member's fund.
- Model 4 – the pension income builder which explores a model of collective risk sharing that could provide a guaranteed pension income. Broadly speaking, this involves a proportion of the contributions being used to purchase a deferred nominal annuity, payable from the current pension age, with the residual proportion invested into a collective pool which is used to provide future indexation on a conditional basis.

The DWP states that it is continuing to work with industry and other Government departments to explore the regulatory barriers to development and delivery.

Collective DC

The DWP also states that it believes that Collective DC schemes offer an alternative approach to risk sharing and it proposes to explore further the policy issues and legal implications of the changes that would be required to the legal framework to enable them to operate in the UK.

Legislative approach

The consultation also sets out the high level options to facilitate DA in legislation and proposes a new framework which clearly defines DA and DB schemes with the definitions in primary legislation and the specific requirements attaching to the different types of schemes set out in regulations.

Next steps

The DWP is continuing to build the evidence base around DA and the findings of further research on the consumer perspective are expected late in 2013. The DWP is also continuing to work with stakeholders to gather further analysis.

The consultation closes on 19 December. The DWP will publish a report containing a summary of responses and the action it will take as a result and aims to consult on draft legislation in the New Year.

CHARGES IN DC SCHEMES

In the October edition of Pensions News, we reported on the DWP's consultation on pension charges which explores options around transparency and caps on charges in default funds of DC schemes which are qualifying schemes for the purposes of the automatic enrolment legislation. Two further publications were issued by the DWP in November in relation to charges.

Call for responses

On 15 November the DWP issued a press release stating that whilst the consultation had received support from consumer and trade organisations the Government wants to ensure that pension savers have a chance to put their views forward. It therefore urged people to take part in the consultation before it closed. The consultation subsequently closed on 28 November and a response is now awaited.

Research on charges

Also on 15 November, the DWP published the findings of quantitative research on annual management charges (AMCs) in trust-based and contract-based DC schemes conducted in April and May of 2013.

Respondents to the survey

The survey involved telephone interviews with schemes in respect of which an employer contribution is paid and which have six or more members. There were 593 interviews with trust-based schemes and 717 interviews with contract-based schemes and 85% of trust-based and 74% of contract-based schemes were able to confirm member charges.

This meant that over 800 employers reported the level of AMC paid by members compared to around 300 in 2011. This increase in participation was achieved by researchers working with employers to explain how they could find out the level of AMC from their pension providers.

Results for trust-based schemes

The average AMC was 0.75% with members of the largest schemes paying far less at 0.42%. Those paying the highest charges of greater than 1% were found to be those on low salaries and with low employer contributions and those whose employers used a commission-based adviser.

Results for contract-based schemes

The average AMC was 0.84% with members of the largest schemes paying far less at 0.51%. The schemes most likely to face charges of greater than 1% were older schemes (such as those sold before 1991), as well as stakeholder pensions, smaller schemes and schemes with lower employer contributions.

Issues affecting the level of the AMC

The report sets out a brief list of findings in relation to factors that contribute to the level of the AMC. This includes that:

- commission on pension schemes sold in the last year added around 0.2% to the AMC according to providers and 0.2% to 0.4% according to data from employers;
- salary and level of employer contributions had an impact on the AMC; and
- employer awareness of additional member-specific and fund-specific charges was low.

Next steps

The DWP will publish full findings from the research in early 2014.

CONSULTATION ON DRAFT MISCELLANEOUS AMENDMENTS

On 29 November the DWP issued a consultation on draft regulations which it is proposed will make three sets of miscellaneous amendments to pensions legislation with the aim of simplifying administration.

Auditor appointments

The proposal here is that restrictions on eligibility to be a scheme's auditor (for example, for scheme members or scheme administrators) will be removed for trust-based, multi-employer occupational pension schemes where at least two thirds of the employers are not associated or connected and there are at least 500 employers in the scheme.

This is in recognition of the practical difficulty that these very large schemes could have in complying with the restrictions.

Discharge for trustees

Where schemes bulk buy annuities or insurance policies on behalf of deferred members, they can benefit from a statutory discharge of their liability to provide benefits for those members.

In certain circumstances trustees can choose annuities or insurance policies which include a commutation option for members to take a proportion of their benefits as a lump sum. The discharge for the trustees will still apply in such cases provided certain requirements are satisfied. However, the current version of the legislation does not set out these provisions and the consultation states that it appears that they were omitted in 2006 when other amendments were made to the legislation.

The DWP states that it has always been the policy that trustees can purchase annuities that include an option for a tax-free pension commencement lump sum and the proposed amendment therefore intends to put the options that are available beyond doubt.

Section 75

The final amendments simply update a cross reference (without changing the policy) in the part of the employer debt regulations which relate to the unusual circumstances (referred to as where the "criminal reduction conditions" are met) where employers can be liable to pay amounts to money purchase schemes under section 75.

Timing

The consultation closes on 10 January 2014 and it is proposed that the regulations will come into force on 5 April 2014.

CASE LAW

CONTRIBUTION NOTICES

Background

In May 2010, the Determinations Panel of the Pensions Regulator decided that it would be reasonable to issue Contribution Notices (**"CN"**) to two individuals in respect of the Desmond & Sons 1975 Pension & Life Assurance Scheme (**"Scheme"**).

A reference was subsequently made by the Scheme's trustee to the Upper Tribunal contending that a CN should also have been imposed on another shareholder of the scheme employer.

The relevant act was said to be that the shareholder had voted at a meeting on 3 June 2004 for the company to enter into Members' Voluntary Liquidation (**"MVL"**) which had resulted in it being treated as insolvent for the purposes of calculating the employer debt payable (even though it was fully solvent). This meant that the debt was calculated on a Minimum Funding Requirement (MFR) basis, leaving the Scheme underfunded on a buy-out basis.

In the Upper Tribunal, the shareholder successfully argued that the Tribunal would not be able to direct the Regulator to issue a CN against her because it would be outside of the statutory six year look back period which expired on 2 June 2010 (six years after the relevant act on 3 June 2004).

The trustee and Regulator appealed to the Court of Appeal in Northern Ireland which issued its judgment in November 2013.

Whilst the judgment relates to the legislation relevant to Northern Ireland, this is substantially the same as the legislation for England, Wales and Scotland.

Decision of the Court of Appeal

The Court concluded that the Tribunal could direct the Regulator to issue a CN against the shareholder without this causing a breach of the six year look back period with its reasoning including that:

- the Tribunal has the power to substitute a different decision for the Panel's decision;
- such a new decision takes the place of the original decision from the date that the original decision was made by the Panel;
- the statutory provisions under which the Tribunal remits matters to the Regulator and the Regulator has to comply with the Tribunal's directions do not re-engage the part of the legislation that contains the six year look back period; and
- it is therefore for the Tribunal to determine whether on a reference it should substitute a decision to exercise the power to issue a CN in place of the determination not to do so.

The Court noted that this is broadly consistent with the June 2013 decision of the English Court of Appeal that a two year look back period in relation to Financial Support Directions (FSDs) does not apply to any directions the Upper Tribunal may give regarding an FSD or any order made on appeal from the Tribunal's directions.

It should be noted that this judgment considered only the question about time limits and not the question of whether a CN should be issued.

OTHER NEWS

UPDATE ON FAIR DEAL

In the October edition of Pensions News we reported on the publication of the new Fair Deal guidance which applies where employees are compulsorily transferred out of the public sector to an independent provider, such as on an outsourcing. Fair Deal is not mandatory although in our experience the majority of contracting authorities require it to be followed.

The policy used to specify that pension protection for transferring employees should take the form of the new employer providing a broadly comparable scheme for future service and allowing bulk transfers of accrued benefits to that scheme. However, the new guidance states that the protection should be provided by the new employer participating in the relevant public service pension scheme with transferring staff able to remain in that scheme for so long as they remain employed wholly or mainly in the provision of the services.

The new policy took immediate effect when it was issued on 4 October, although there are some circumstances where the old policy will continue to apply, one of which is where the relevant public service scheme has not yet made any changes needed to permit the participation of the new employers and the continued membership of the transferring staff. However, the new guidance must be followed in all cases from April 2015.

For those involved with outsourcing contracts, it will therefore be important to know when any amendments that are needed are made to the relevant public service scheme. Two further developments on this issue have taken place.

Civil Service pensions

We noted in the October edition of Pensions News that a House of Commons Library Note had reported that amendments were made to the Principal Civil Service Pension Scheme on 9 October.

Those amendments have now been published on the Civil Service website along with Admission Agreements (by which independent employers can participate in the scheme) and associated guidance notes.

There are two Admission Agreements:

- a two-party agreement which applies where the only parties are the independent employer and the scheme, which is said to typically be the case where there is no ongoing contractual relationship between the exporting and receiving employer; and
- a tri-partite agreement where the parties are the independent employer, the scheme and the contracting authority.

The update to the Civil Service website also states that contracting authorities should allow a minimum of six months from the date they contact the Pension Scheme Executive to inform them of a staff transfer and the transfer taking place and that, in all circumstances, it is better to make contact with the Pension Scheme Executive as early as possible in the process.

Teachers' pensions

On 12 November, the Department for Education issued a consultation in relation to its approach to introducing new Fair Deal arrangements into the Teachers' Pensions Scheme. The proposed approach includes the following.

- The regulations which govern the scheme will be amended to provide for continued access which will be dependent on the participating employer and the contracting authority signing a Participation Agreement and fulfilling any obligations under this agreement and/or the scheme, for example, providing information on transferring staff.
- The regulations will be amended to require contractors to auto-enrol all eligible staff into the scheme (including those who have previously opted out) on the first day of the new contract, although they will be able to opt out. From this point onwards the overriding legislation on automatic enrolment will come into effect.

- The regulations will be amended so that where an employer has failed to fulfil its obligations or there are concerns it may not fulfil them, the Department for Education may require the employer to support its application with a bond, guarantee or indemnity.

A draft model Participation Agreement was published as an annex to the consultation.

The consultation closes on 7 January 2014 and it is intended that the results of the consultation will be implemented in the regulations in April 2014.

REVALUATION ORDER

On 16 November the annual Occupational Pensions (Revaluation) Order was made for 2013 coming into force on 1 January 2014.

This Order sets out the statutory minimum revaluation required for those people who will reach their scheme's normal pension age in 2014. The revaluation percentages have been updated to reflect the CPI figure for the year to 30 September 2013 of 2.7%.

This is also the percentage figure used to calculate minimum statutory pension increases, although these are capped at 2.5% for pensions accrued after 6 April 2005.

SMPIS – AMENDMENTS TO TM1

The Disclosure Regulations require the pension illustration in Statutory Money Purchase Illustrations (SMPIs) to be calculated by reference to the Financial Reporting Council's (FRC) document "*AS TM1: Statutory Money Purchase Illustrations*" (TM1).

We reported in the October edition of Pensions News that regulations have been made which come into force on 6 April 2014 which consolidate, harmonise and simplify the regulations on disclosure for occupational and personal pension schemes into one set of regulations. Changes made in the new regulations include enabling some flexibility in SMPIs so that they can take more personalised assumptions into account.

On 15 November the FRC published a fast-track consultation on proposed amendments to TM1 to reflect the changes to the SMPI requirements being introduced by the new disclosure regulations. In summary, the amendments proposed to TM1 include the following.

- Amendments to allow for cash lump sums to be taken out prior to the calculation of the illustrated pension.
- Amendments to state that the assumed amount of any spouse's or civil partner's pension should not usually exceed the amount permitted under the scheme's rules or legislation. This will enable varying levels of dependants' pensions to be assumed compared to the current position where the legislation provides that SMPIs usually have to include a 50% dependant's pension.
- A formula for determining the interest rate to be used in calculating an annuity rate that does not increase in payment and amendments to allow pension increases to be assumed at a rate other than inflation.

The consultation closes on 13 December 2013. Subject to the responses, it is intended that the final version of the updated TM1 will be published so that it is effective for SMPIs issued on or after 6 April 2014 to coincide with the new regulations coming into force.

The FRC states that it does not envisage this relatively short time period for implementation causing any difficulties because the changes for SMPIs are optional.

Trustees may wish to consider whether to take advantage of the flexibilities that will be available from 6 April 2014 to allow more personalised illustrations and, if so, will need to ensure that the necessary changes are made to their processes.

AMENDMENTS TO IAS19

In the September edition of Pensions News, we reported that the International Accounting Standards Board had decided to proceed with amendments to "*IAS 19 Employee Benefits*" which is the document that sets out the accounting requirements for employee benefits.

The amendments were published on 21 November and are stated to apply to contributions from employees or third parties to DB schemes and have the objective of simplifying the accounting for contributions that are independent of the number of years of employee service (for example, employee contributions calculated according to a fixed percentage of salary).

The amendments take effect from 1 July 2014 although earlier application is permitted.

ON THE HORIZON

- **PPF levy.** The consultation on the levy for 2014/15 closed on 24 October 2013.
- **Exceptions to automatic enrolment duties.** A consultation is due to be published in the autumn.
- **IORP Review.** Proposals to amend the IORP Directive in relation to governance and transparency are expected to be published in the autumn.
- **Personalised lifetime allowance.** A summary of responses to the consultation and updated draft legislation are expected to be published in the autumn.
- **Pension protection following TUPE transfer.** The consultation on amendments to this legislation closed on 5 April 2013. The changes were originally proposed to come into force on 1 October 2013 but the final form regulations and response to consultation are awaited.
- **Employer debt.** The consultation on amendments to the "restructuring provisions" closed on 7 June 2013. The changes were originally proposed to come into force on 1 October 2013 but the final form regulations and response to consultation are awaited.
- **Finance Bill.** Draft clauses for the Finance Bill 2014 will be published for consultation on 10 December 2013 with the consultation closing on 4 February 2014.
- **DC charges and scheme quality.** The DWP's consultation on DC charges closed on 28 November 2013 and, following this consultation, the Government will publish proposals on charges and scheme quality.
- **Public service schemes.** Later in the year, the Regulator will consult on a regulatory strategy and codes of practice for the public service schemes which fall within its remit under the Public Service Pensions Act 2013.
- **IORP solvency.** Further details of EIOPA's work programme on IORP solvency will be published later in 2013.
- **RPIJ.** The Office for National Statistics must report to the UK Statistics Authority by the end of 2013 on the implementation of specified enhancements to RPIJ so that it can be designated as a National Statistic.
- **PPF's insolvency risk provider.** New insolvency risk scores will be available in early 2014 and will be used for the 2015/16 levy year.
- **DC regulation.** In the first quarter of 2014 the Regulator is expected to publish a template governance statement which trustees of occupational pension schemes can use to report the extent to which their scheme complies with the DC quality features.
- **Defined ambition.** The DWP's consultation closes on 19 December 2013. A report summarising responses and the action that will be taken as a result will subsequently be published. The DWP aims to consult on draft legislation in this area in the New Year.
- **Simplification of automatic enrolment.** Some of the simplifications came into force on 1 November 2013 and the changes in relation to joining windows will come into force on 1 April 2014.
- **Disclosure.** The new regulations will come into force on 6 April 2014. Proposed amendments to the TM1 guidance on Statutory Money Purchase Illustrations to bring it into line with the new regulations are also due to come into effect on 6 April 2014.
- **Changes to the annual allowance and the lifetime allowance.** The lifetime allowance will be reduced to £1.25 million and the annual allowance to £40,000 for tax years 2014/15 onwards.

PENSIONS NEWS

- **Money purchase definition.** Amendments to the definition of money purchase benefits are expected to come into force on 6 April 2014 with retrospective effect to 1 January 1997. Supporting regulations which provide some easements to the retrospective effect are also expected to come into force on 6 April 2014.
- **Pensions Bill.** The Minister for Pensions has stated that it is hoped that the Bill will receive Royal Assent by Easter 2014.
- **Equalisation for GMPs.** During the Parliamentary debate on the Pensions Bill, it was reported that guidance on GMP conversion (which will provide guidance on an alternative method by which schemes can equalise benefits including GMPs prior to conversion) is expected to be provided by spring 2014.
- **Master Trust Assurance Reporting.** The consultation on draft guidance on independent assurance reporting for master trusts closes on 16 December 2013 and final guidance is expected to be published in spring 2014.
- **Short service refunds.** It is intended that short service refunds will be withdrawn from money purchase schemes in 2014.
- **Fiduciary duty.** The Law Commission's consultation on fiduciary duties in relation to investments closes on 22 January 2014 and a report (containing recommendations) is expected to follow in June 2014.
- **State Pension.** The reform of state pension which would result in the end of contracting-out is proposed to take effect in April 2016.

CONTACT DETAILS

Cathryn Everest
Professional Support Lawyer, London
T +44 (0)20 7153 7116
cathryn.everest@dlapiper.com

David Wright
Partner, Liverpool
T +44 (0)151 237 4731
david.wright@dlapiper.com

Claire Bell
Partner, Manchester
T +44 (0)161 235 4551
claire.bell@dlapiper.com

Tamara Calvert
Partner, London
T +44 (0)20 7796 6702
tamara.calvert@dlapiper.com

Michael Cowley
Partner, London
T +44 (0)20 7796 6565
michael.cowley@dlapiper.com

David Farmer
Partner, London
T +44 (0)20 7796 6579
david.farmer@dlapiper.com

Jeremy Harris
Partner, Manchester
T +44 (0)161 235 4222
jeremy.harris@dlapiper.com

Vikki Massarano
Partner, Leeds
T +44 (0)113 369 2525
vikki.massarano@dlapiper.com

Ben Miller
Partner, Liverpool
T +44 (0)151 237 4749
ben.miller@dlapiper.com

Kate Payne
Partner, Leeds
T +44 (0)113 369 2635
kate.payne@dlapiper.com

Matthew Swynnerton
Partner, London
T +44 (0)20 7796 6143
matthew.swynnerton@dlapiper.com

www.dlapiper.com