HYMANS ROBERTSON

# Current issues

February 2023

Articles this month:

DC developments
AE thresholds unchanged for 2023/24
New guidance from Regulator
Actuary had discretion to '*determine*' deficit-reduction contributions
Auto-enrolment: reasonable excuse for non-compliance
GMP Increase Order
HMRC newsletters: January 2023

## DC developments

On 30 January 2023 the Department for Work and Pensions (DWP) published a bundle of documents concerned with developments in the defined-contribution (DC) pensions arena. They are billed as measures that will '*will help address the pension inequality gap*' that has arisen with the decline in the number of defined-benefit schemes. The plans include proposals for extension of collective money purchase schemes, a 'value for money' (VFM) framework and a call for evidence connected with possible systems for the automatic consolidation of small deferred pension pots, as well as confirmation of amendments intended to facilitate greater investment in illiquid assets.

Read on for summary details of each initiative.

### Collective DC

The *Pension Schemes Act 2021* accommodates collective money purchase (commonly called collective defined contribution—CDC) schemes within the UK system, and establishes an authorization framework. The legislation as it stands permits only CDC schemes for individual employers or groups of connected employers. No such schemes have yet been cleared to commence operations.

From the outset, commentators (ourselves included) have maintained that, for widespread adoption of CDC, the statutory restrictions will have to be loosened; a proposition long accepted by the DWP. To that end, it now proposes to allow the creation of—

- '*whole-life*' (i.e. encompassing both benefit accumulation and decumulation) schemes for unconnected employers; and
- decumulation-only arrangements.

This is another step towards equipping pension providers with the tools to design decumulation solutions that meet the needs of future DC savers. Collective DC in decumulation might not be right for everyone, but, it would offer a solution that bridges the gap between the flexibility and risk of drawdown and the irreversible certainty of annuities.

## Value for money

On value for money (VFM), the DWP is keen to facilitate comparison and competition between DC schemes, as a means of improving member outcomes. It wants to move away from VFM assessments focused primarily on costs and charges.

In collaboration with the Regulator and FCA, it proposes to require disclosure of—

- historical investment performance, net of costs;
- asset allocation;
- projected returns;
- more detail of costs and charges; and
- various quality-of-service metrics, encompassing matters such as effectiveness of communications and transaction processing.

In the interests of consistency of disclosures, the Government is considering the use of a prescribed reporting template, and plans to introduce common reporting dates. It is also debating whether to require publication on providers' websites, or on a centralized repository.

The consultation document notes that these proposed new disclosures are distinct from those currently made in annual governance (Chair's) statements. However, it also confirms that the Government is reconsidering the rationale and purposes for Chairs' statements, in the light of these VFM proposals and the enhanced governance expectations (such as the requirements for ‘own-risk assessments) that will be laid out in the Regulator’s new single Code of Practice.

The DWP is proposing to require trustees to follow a mandatory, step-wise process for assessing VFM, at the end of which each scheme would be declared to be—

- value for money,
- not *currently* VFM, but with improvements planned, or
- not VFM, and with no prospect of becoming so within a reasonable period.

A colour-coding system using green, amber and red indicator system is being considered. Those falling into the ‘not VFM’ category would be required to consider winding up. The DWP is pondering whether to require comparison to regulator-defined benchmarks or (as is currently done for the enhanced VFM assessments included in Chair’s statements) against other schemes.

The proposed changes would affect both trust and contract-based schemes. The DWP is proposing a phased implementation process, starting with default investment arrangements in workplace schemes. A subsequent phase would expand the requirements to take in self-selected funds, non-workplace schemes and pensions during the decumulation stage.

We are pleased to see that feedback from the pensions industry about value for money has been heeded: the commitment to shift the focus from costs to long-term outcomes is much welcomed. However, we would like to see it go further, with the inclusion of explicit outcomes metrics.

We also welcome the prospect of a radical re-think of the purpose and contents of the Chair’s statement (see additional comments at the end of this article). It is long overdue: the statement has evolved—some might say, degenerated—since its conception into a ever-longer and more-complex compliance document. We hope that consultation will result in significant changes.

## Small pots: the proliferation problem

The DWP wants to gather more information about the problem of and possible solutions to the proliferation of small, deferred DC pots, so has called for evidence from scheme providers, trustees, members, trades unions, consumer groups, employers and pension-industry professionals. It is focusing primarily on models under which pots would either be transferred between employers' schemes as employees change jobs ('pot-follows-member') or would transfer automatically to a 'default consolidator'.

The Government is looking for a solution that will—

- provide net benefits for members (improved value for money, meaningful reduction in number of deferred pots);
- complement member engagement;
- support a healthy (trust and contract-based) pensions market;
- minimize complexity and administrative burdens; and
- command public confidence.

An automatic-consolidation solution that prevents the erosion of small pots by charges could, together with the advent of pensions dashboards, be a valuable part of a higher-level action plan to improve member outcomes and increase engagement.

## Encouraging investment in illiquids

Lastly, the DWP has announced the outcome of 2022's consultation exercise on *Broadening the Investment Opportunities of Defined Contribution Pension Schemes*. It has now laid before Parliament revised Regulations[1] that will, in connection with default investment arrangements—

- allow the exclusion of performance-based fees from charge-cap calculations—effective from 6 April 2023; and,
- require disclosure of
- performance-based fees—applying to annual governance (Chairs') statements in respect of the first scheme year to end after 6 April 2023;
- asset allocations—applying to Chairs' statements in respect of the first scheme year to end after 1 October 2023; and,
- illiquid-assets policies—on the first occasion on which trustees revise their default statement of investment principles (SIP) after 1 October 2023, or by 1 October 2024 at the latest.

The information will also have to be made publicly available free of charge on a website. The DWP has published statutory guidance on asset-allocation reporting and the new rules for the interaction of performance-based fees with the charge cap.

As we have consistently said, we support the Government's goal of facilitating a wider universe of investment opportunities, including illiquid assets; and we are pleased to see the requirement for trustees to have formal policies on illiquid assets. However, we remain opposed to additional reporting requirements via the Chair's statement, increasing the already-excessive compliance burdens and costs associated with the documents.

## AE thresholds unchanged for 2023/24

The Department for Work and Pensions (DWP) has made a statement in Parliament about the auto-enrolment earnings trigger and qualifying earnings band for 2023/24. It is keeping all of the numbers from 2022/23, so the earnings trigger will be £10,000, and the QE band will run from £6,240 to £50,270.

The DWP has also published some supporting analysis for its decisions. Looking to the future, it says that:

> '*The 2017 Review of Automatic Enrolment set out the ambition to remove the LEL in the mid-2020s. Government remains committed to this, subject to discussions with employers and other stakeholders on the right implementation approach, and finding ways to make these changes affordable. We will pay close attention to the impact and costs in order to develop an optimal approach on implementation which balances the needs of savers, employers and tax-payers. This will include giving employers and savers the time to plan for future changes to help minimize any risk of deterring individuals from continuing to save or undermining employer engagement.*
>
> *'This longer-term policy direction does not pre-empt any future annual thresholds review, pending the introduction and enactment of legislation to remove the LEL.*'

## New guidance from Regulator

### *Supporting defined contribution savers in the current economic climate*

The Pensions Regulator has issued a guidance statement for defined contribution (DC) scheme trustees and advisers, encouraging communication with members about the effects on fund values of recent market volatility. It also calls for trustees to review their investment and governance arrangements, and the remit of their advisers; and to understand the characteristics of their membership and take steps to support better outcomes. There is a checklist of actions at the end of the statement.

### *Dealing with transfer requests*

The Regulator has also updated its guidance on *Dealing with transfer requests* to emphasize that, when told that their transfer request raised an 'amber flag' and they will as a consequence need to undergo guidance before proceeding, members need to book (for themselves) a MoneyHelper pensions safeguarding session, and *not* the sort of Pensions Wise appointment that trustees must offer to book on behalf of members under the new DC 'stronger nudge' rules.

## Actuary had discretion to '*determine*' deficit-reduction contributions

The High Court in England and Wales has ruled on the meaning of pension scheme rules that allow contributions to be '*determined*' by the scheme actuary.[1] It agreed with the trustee that the phrase endowed the scheme actuary with discretion over the contributions that ought to be paid, in light of relevant considerations.

### History

The case is concerned with a section of the Railways Pension Scheme (RPS), which was established in 1994 as a consequence of the privatization of British Rail. The section's contributions rules are rather complicated, and all the more so for being overlaid with legislation safeguarding the positions of '*protected persons*': members who had been around since the time of privatization.

In essence, the section is intended to operate, in normal circumstances, on a 'shared cost' basis, so that the required contributions are split 60:40 between sponsors and members. However, this is subject to provision for what should happen when an actuarial valuation shows that there is a funding deficit. Unless agreement is reached, within six months, on a plan to '*make good*' the shortfall, the scheme actuary is required to '*determine*' various matters, including the increases to the employers and employee contributions that should be paid. The rule contains a cap on the employers' contributions as a percentage (130%) of their normal long-term funding rate (although the cap can be waived with the principal employer's agreement), so in the event that the increased contributions are still insufficient to make good the shortfall, the actuary is also instructed to determine what reductions to future-service benefits are necessary to restore balance.

[1] *Railways Pension Trustee Company Limited v Atos IT Services UK Limited and another* [2022] EWHC 3236.

The legislative overlay (Protection Order) was put in place in 1994, at the time of privatization.[2] It says, in effect, that the employers of protected persons must continue to provide them with access to a scheme in which they accrue pension rights that are no less favourable than those under the pre-privatization scheme. Pre-privatization benefit entitlements that were transferred in are also safeguarded. Employers are required to pay contributions at least sufficient (in the opinion of the scheme actuary) to fund the rights of protected persons. The trustees of a scheme containing protected persons are not allowed to increase member contributions or reduce their benefits except to the extent that it would have been allowed under the pre-privatization scheme.

The section for the employers' protected persons was considered '*extremely well-funded from the outset*', and the costs of setting up and running a separate scheme or segregated section for employees taken on after privatization were unattractive. This meant that (in common with most other sections of the RPS) the section contained both protected persons and later joiners.

### Dispute

The section's 2013 actuarial funding valuation recorded a £6m deficit, and the indications were that the shortfall was approximately three times as high (at £19m and £18m) by the effective dates of the 2016 and 2019 valuations. Questions arose between the employers and the trustee over the interpretation of the contribution rules, subject as they are to the Protection Order, when such a funding shortfall arises. The dispute has impeded the completion of the 2016 and 2019 valuations.

### Decision

The High Court judge concluded (in broad summary) that the various references to matters being '*determined*' by the actuary imply '*the exercise of judgement and discretion*', and '*not simply… a mechanical mathematical calculation*'. More specifically, the words '*the contributions… shall be increased…as determined by the Actuary*' give the scheme actuary '*a discretion as to whether to increase the contributions at all and, if so, by how much*'. That meant that the actuary could determine a member contribution rate that is less than is required to make good the funding shortfall. Relevant considerations include, for example, whether the actuary thinks that the full increase and/or benefit reduction would result in active members opting out, and whether that outcome would worsen the funding position.

The Protection Order rules out the lifting of the 130% employer-contribution cap, and prevents the reduction of future-service benefits, if those actions would be likely to cause active members to opt out. It also obliges the employers to make good the funding shortfall left behind by these statutory constraints upon the routes that would otherwise be open to the employers and trustee under the section's rules. Moreover, because the section is unsegregated, the Order effectively applies to both protected and unprotected members.

Although the circumstances of this case are atypical, it seems destined (subject to appeal) to be cited in other situations in which contributions are 'as determined by the scheme actuary'. Such phrases are encountered in other schemes' rules, even outside of formerly nationalized industries.

## Auto-enrolment: reasonable excuse for non-compliance

A recent First-tier Tribunal judgment is a rare case of a successful appeal against penalties imposed for failure to comply with automatic-enrolment obligations.[2] There has been a litany of such cases recently, in which the appellant invariably claims that it did not receive the Pensions Regulator's correspondence, and the FTT judge (almost) invariably sides with the Regulator.

There is a statutory presumption that properly addressed correspondence is received by the addressee. Although the presumption is rebuttable, most appellants so far have merely asserted that mail was not received, rather than providing supporting evidence.

In this case, the Regulator, for reasons that it did not explain, sent correspondence to an address that was not that of the appellant's registered office. The judge concluded that the Regulator had nevertheless used a '*proper address*' address for the purposes of the legislation, in the sense that it was where the business actually operated. However, she said that the appellant had a reasonable excuse for not complying with the Regulator's notices.

---

[2] *Bolton Gate Farm Limited v The Pensions Regulator* [2023] UKFTT 00037 (GRC).

It emerged that the address used by the Regulator was shared with two nearby properties. The Regulator's correspondence was delivered to a locked post box, situated 100 metres away from the appellant's café business, that had been used by the tenant of a cottage on the same piece of land since a time before the appellant's occupancy of its premises. It was for this reason that the appellant's registered office was that of its accountant. The tenant had arranged for mail to be re-directed to a new address after she moved away. When the diversion period ended, the mailbox filled up to the point of overflowing, so that the appellant eventually forced it open, and in doing so discovered arms full of the tenant's junk mail—and compliance notices sent to it by the Regulator.

The judge accepted the appellant's evidence. Although the notices were correctly served, in her opinion, the presumption of receipt had been rebutted. She rejected the Regulator's assertion that the appellant had failed to manage its post properly, noting that the mail was in a locked box belonging to someone else, and that the appellant was not expecting business correspondence from the Regulator—or anyone else—to be delivered to it instead of its registered office address.

The judge determined that the issuing of penalty notices was not appropriate action in this case, and directed that they should be set aside.

One wonders whether the Regulator's overwhelming success rate in arguing against these 'mail not received' excuses had resulted in something like tunnel vision. Regardless, it shows how unusual the circumstances must be for there to be a chance of overturning a non-compliance fine.

## GMP Increase Order

The Department for Work and Pensions (DWP) has laid before Parliament a draft of the *Guaranteed Minimum Pensions (Increase) Order 2023*, which would determine the increases to GMPs in payment, in so far as they relate to the tax years 1988/89 to 1996/97. As expected, given the 10.1% increase in the Consumer Prices Index for September 2022, the draft Order provides for the maximum 3% increase required under the relevant legislation.

## HMRC Newsletters: January 2023

*Pension Schemes Newsletter 146*, from His Majesty's Revenue and Customs (HMRC), covers the following:

- information for schemes operating '*relief at source*' for members' contributions;
- HMRC processed more than 14,000 tax repayment claim forms connected with pensions flexibility in the last quarter of 2022, and repaid more than £45m;
- event reports for the tax year 2023/24 onward will have to be submitted via the online Managing Pension Schemes service (MPSS) —there will be some system downtime between April and the summer of 2023;
- trustees asked to file a pension scheme return for the 2023/24 tax year will need to do so on the MPSS—the return will ask for more detail;
- Accounting for Tax returns for the second quarter of 2023 onward will ask new annual- and lifetime-allowance questions for public sector schemes affected by the '*McCloud*' judgment; and,
- when administrators ask HMRC to confirm the status of the receiving scheme for a transfer, they can (by jumping through some hoops) request a response by email.

**And Finally…**

Some words of advice to whoever manages the Department for Work and Pensions' official Twitter channel:

When tweeting a video of a Minister, do make sure that you watch the clip all the way to the end. You might not otherwise realize that—for example, and speaking entirely hypothetically—when you say that the Pensions Minister's panegyric for pensions dashboards was delivered *'To unanimous agreement'* in the House Commons, the camera will pan out to show that there's only half a dozen people in attendance, and only two of them seem to be paying any attention…



This communication has been compiled by Hymans Robertson LLP, and is based upon their understanding of legislation and events as at the date of publication. It is designed to be a general information summary and may be subject to change. It is not a definitive analysis of the subject covered or specific to the circumstances of any particular employer, pension scheme or individual. The information contained is not intended to constitute advice, and should not be considered a substitute for specific advice in relation to individual circumstances. Where the subject of this document involves legal issues you may wish to take legal advice. Hymans Robertson LLP accepts no liability for errors or omissions or reliance on any statement or opinion.

Hymans Robertson LLP (registered in England and Wales - One London Wall, London EC2Y 5EA - OC310282) is authorised and regulated by the Financial Conduct Authority and licensed by the Institute and Faculty of Actuaries for a range of investment business activities. A member of Abelica Global. © Hymans Robertson LLP.