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Facilitating illiquid investment by DC schemes

The Department for Work and Pensions (DWP) announced a consultation exercise on *Broadening the Investment Opportunities of Defined Contribution Pension Schemes*. It invites comments on draft Regulations designed to exclude performance fees from the charge-cap calculations for default investment arrangements, and to require trustees to explain their policies on illiquid investments and publish details of their performance-fee outlays and asset allocations for those default funds. The DWP also published draft statutory guidance about the changes.

The proposals would generally affect occupational schemes providing money purchase benefits. However, existing exemptions would prevent their application to small self-administered schemes and those for company directors, and the current definition of '*default arrangement*' excludes those used only for additional voluntary contributions.

Charge cap rules

The Government proposes to delete existing provisions that allow smoothing of performance-based-fees. Instead, it would exclude '*specified performance-based fees*' from the definition of '*charges*' in the legislation. If trustees have made use of the existing fee-smoothing options, the amendments would not take effect until the first charges year that ends after the earlier of—

- the date five years after the end of the charges year in which the trustees first took up the fee-smoothing option; and
- 5 April 2028.

'Disclose & explain'

Trustees would need to update the statement of investment principles (SIP) for their default arrangement (or arrangements) to describe their policy on investment in illiquid assets, and explain how it serves members' best interests. This requirement would be effective from earlier of—

- the first date on which the default SIP is revised after 1 October 2023; and
- 1 October 2024.

In their annual governance ('Chair's') statements, trustees would need to detail the performance-based fees incurred in connection with their default arrangement during the year in question, as a percentage of the average value of the assets held in that arrangement. They will need to assess how those fees represent value for members. Both obligations would be effective for the first scheme year ending after 6 April 2023.

The Chair's statement would also need to detail the results of an annual assessment of their asset allocation, showing the percentage of the assets of their default arrangements that allocated to specified asset classes (cash, bonds, listed shares, unlisted shares, infrastructure, other property, other debt instruments, and '*other*'). The initial assessment would be required for the first scheme year ending after 1 October 2023.

The information from the Chair's statement about the performance-based fees incurred under the default arrangement and the asset-allocation assessment would need to be extracted and made freely available online.

Collective money purchase schemes

Parallel requirements would be made for collective money purchase (also known as collective defined contribution) schemes.

Consultation arrangements

The consultation document also represents the Government's response to one part of the March 2022 consultation exercise on *Facilitating Investment in Illiquid Assets*.

The consultation period on the draft Regulations and statutory guidance runs ends on 8 November 2022. The draft Regulations are composed so as to come into force on 6 April 2023.

This consultation exercise about encouraging investment in illiquid assets was exquisitely timed for release during the recent liquidity crisis, even though that mainly affected defined benefit schemes. Nevertheless, we are in favour of changes making it easier for DC schemes to access a wider universe of investment opportunities, and of the requirement for formal policies on illiquid assets. We are, however, disappointed in the Government's continued enthusiasm for cost- and governance-reporting requirements that add little value. Further expanding the scope of the already rather distended Chair's statement will add to costs and pressure on trustees, emphasise minutiae, and draw focus away from areas that would actually improve member outcomes.

Dashboards Regulations laid in Parliament

The Department for Work and Pensions (DWP) has laid draft *Pensions Dashboards Regulations 2022* before Parliament, for the approval of each House. If the necessary affirmative resolutions are forthcoming, the Regulations will establish the obligations of trustees and managers of occupational pension schemes to connect and supply information to the dashboards system, and what is expected from those who wish to offer dashboard services.

The DWP began a consultation exercise on its proposals for the legislation in January 2022 (see our Sixty Second Summary, *Dashing Ahead with Dashboards*), and announced its conclusions in July 2022 (see the article *DWP tweaks Dashboards Regulations*, in *Current Issues* August 2022). A separate consultation paper was published in June 2022 about ability of the Pensions Regulator and the Money and Pensions Service to share information concerning dashboards, and the amount of forewarning that the pensions industry should receive about the '*dashboards available point*': when the Government concludes that dashboard information is ready for use by the general public. Several changes have been made to the draft legislation in light of the comments obtained. Most notably,

- the DWP will give six months' (rather than 90 days') prior notice of the '*dashboards available point*';
- the deadlines by which the schemes in the vanguard must connect to the dashboards system have been extended by two months (for authorized master trusts with 20,000 or more active and deferred members the staging deadline will be 31 August 2023, and in the case of money purchase auto-enrolment schemes that have 10,000 or more such members it will be 30 September 2023);
- the Regulations now specify how the obligations to connect and supply data will be affected by a scheme's assessment for entry into the Pension Protection Fund, or by winding up (in broad summary, the initial connection requirement will be postponed during assessment, and for at least six months afterward if the scheme emerges intact; schemes that are already connected will be exempted from providing dashboard information for the duration of the assessment period; and schemes in wind up will only need to supply administrative—not value—data);
- schemes will be permitted to supply value data extracted from statements that were provided to members within the preceding thirteen months—rather than twelve, as originally proposed (alternatively, value data can be taken from a calculation performed for the member that is no more than twelve months old);

- introducing a simplified, '*alternative accrued value*' option for providing value data to deferred members of defined benefit (DB) schemes during the first two years after connection, if a full calculation would be disproportionately costly and time-consuming; and,
- catering for 'hybrid benefits' (for example, those with an underpin), by allowing some flexibility to use whichever calculation method best represents the value of the member's benefits.

As mentioned above, the draft Regulations will not be considered 'made' until they have been approved by a resolution of each House of Parliament. They will come into force 21 days after they are made.

At the same time as the laying of the draft Regulations, the DWP published its response to the June 2022 consultation paper. It also issued draft guidance for trustees who wish to defer of their staging deadline. Deferment will only be possible if the trustees have a prior commitment to changing or re-tendering for their administrator, and it would mean cause significant difficulties with achieving their staging deadline as set out in the Regulations. Applications for deferred connection will have to be made within twelve months of the date on which the Regulations coming into force.

FCA-regulated schemes

Policy Statement PS22/12 confirms how pensions dashboards will apply to pension providers regulated by the Financial Conduct Authority (mostly personal pensions). Their connection deadline will, generally, be 31 August 2023, which is the same as for the first cohort of occupational schemes, comprising the largest master trusts; however, there is a transitional provision allowing more time for smaller organisations that will rely on a third party for dashboards compliance.

For an introduction to pensions dashboards, and the preparations that you can make, see our August 2022 Briefing Note, *Pensions dashboards are coming*.

Benchmark for statutory increases announced

The Office for National Statistics has announced the inflation figure that will form the basis for many of next year's statutory increases. The official annual rate of inflation for September 2022, using the Consumer Prices Index (CPI) measure, is 10.1%.

The September-to-September increase in CPI is used in the calculations of many inflationary adjustments that take effect in the following year. This means that the 10.1% figure for September 2022 should determine the following (amongst other things) in 2023 –

- increases to 'official' (public-sector) pensions in payment;
- increases to additional State pensions (SERPS and S2P) in payment under the old rules applying to those who reached State pensionable age before 6 April 2016;
- increases to any excess over the full amount of the new State pension to which a person who reached State pension age on or since 6 April 2016 is entitled because of the transitional provisions; and
- adjustments to the opening values of rights under defined benefit arrangements when calculating annual allowance pension input amounts for the 2021/22 tax year.

In some cases the 10.1% will be factored into the equation, but will be prevented from having full effect:

- The minimum statutory increase for pensions in payment accrued after 5 April 1997 will be subject to a cap of either 5% or 2.5% depending on the relevant period of service.
- Guaranteed minimum pensions (GMPs) in payment to the extent that they were accrued after 5 April 1988 will capped at 3%.
- The minimum statutory revaluation of early leaver's pensions (other than GMPs) uses September inflation as a reference point, and will reflect the CPI of 10.1%, but is subject to a cap (either 5% or 2.5% p.a., depending upon the period of service) applied cumulatively over the period of deferment.

Assuming the 'triple lock' is applied for 2023, the basic State pension (as paid to those who reached pensionable age before 6 April 2016) and the new State pension will be increased by 10.1% as this is the higher of the CPI figure, the earnings-inflation figure (5.5%) and 2.5%.

Revaluation of deferred public-sector benefits was, historically, by reference to price inflation. Each of the new career-average revalued earnings (CARE) schemes has its own formula for the revaluation of past years' pensionable earnings.

Between the 2018/19 and the 2020/21 tax years, the lifetime allowance for pensions tax purposes was indexed, rising annually in line with the increase in the September CPI. However, this indexation mechanism has been suspended for the five years from April 2021. The 2022/23 lifetime allowance will remain frozen (at £1,073,100), so there will be a real-terms decrease in its value.

The actual increases in the areas mentioned will be confirmed via statutory instrument in due course.

Employer with confusing address has 'narrow escape'

A recent Tribunal decision provides a rare example of a successful appeal against Pensions Regulator fines for auto-enrolment compliance failures.[1] Third-party evidence of mail-delivery issues trumped a rebuttable presumption that correctly addressed correspondence is properly delivered.

Background

The case concerned an employer's failure to make the triennial re-declaration of compliance required by the automatic enrolment legislation. The Regulator responded with (successively), a compliance notice, a £400 fixed-penalty notice, and an escalating-penalty notice (with fines accumulating at the rate of £500 per day).

There are strict deadlines for applications requesting that the Regulator review notices that it has issued, as well as for any reviews initiated by the Regulator. Appeals to a Tribunal are generally possible only if those review deadlines have been observed. There have been numerous decisions recently in which the Tribunal rejected appeals, despite claims that warnings and compliance notices had not been received (see Current Issues June 2022).

There is a statutory presumption that letters properly addressed and posted by the Regulator are, unless the contrary is proved, effectively served upon the addressee when delivery could have been expected. In this case, however, the employer had, not long before the relevant events, updated its registered office address on the Companies House website, seemingly to reduce potential confusion.

The Regulator's initial batch of notices were revoked because they had been sent using the old address, and were reissued with the correct details. It was not until a letter was sent on 21 January 2021 pointing out that the business had clocked up £14,400 (and counting) in fines that a response was received from the employer's accountant, saying that that was the first his client knew about the penalties, and the missing re-declaration was supplied shortly thereafter. Crucially, as it turned out (spoiler alert), the accountant told the Regulator that he had personal experience of letters to his client going astray.

The Regulator failed to reply to the accountant's letter: the judge noted that this '*omission* [was] *not explained*'. After chasing, the accountant got a response saying that the Regulator had declined to review the fines on the grounds that the relevant application deadline had not been met. The Regulator's response did not address (no pun intended) the accountant's points about the client's problems with the postal service, and subsequent correspondence on the issue seems to have hit the same stone wall.

Judgment

In the judge's view, the employer's case was '*just enough*' to swing the result in its favour. The correct approach was to look to the employer to show a good reason for judicial interference with the penalty under challenge. The presumption of due delivery was a powerful factor, but he was mindful of the employer's difficulty in having to '*prove a negative*', and the '*obvious disadvantage in seeking to do so*.' Whilst an appeal based on mere assertion of non-receipt could not succeed, the judge was satisfied that '*several material factors*' lent extra support to the employer's appeal in this case:

- the confusingly presented address on the Companies House website made it 'quite plausible' that mail was not being delivered correctly;
- the accountant's account (we meant that one) supported the employer's explanation;

[1] DNS Retail Management Ltd v The Pensions Regulator [2022] UKFTT 00363 (GRC).

- the Regulator's envelopes made it clear that they contained important material, making it unlikely that numerous communications were overlooked or ignored;
- the 21 January 2021 letter, unlike the earlier notices, received an immediate response; and,
- there was no suggestion that the business had past 'form' for flouting the auto-enrolment rules.

The judge revoked the escalating-penalty notice. Strictly speaking, the appeal did not cover the fixed penalty notice, but the judge said he hoped that a '*fair-minded regulator*' would conclude that it too should be revoked. He mentioned another technical matter, which was that when an application for review is not made in time and the Regulator does not hold one on its own initiative, there is no jurisdiction in the Tribunal to consider any appeal. In the event, however, the Regulator did not run a jurisdictional defence, so that the issue did not arise.

The employer did not escape admonishment: the judge warned that it must learn from its '*narrow escape*'. It will need to be '*scrupulously careful*' to comply fully with its auto-enrolment duties, and should take all reasonable steps to ensure that properly addressed post is received. The judge said that its chances of persuading a future Tribunal to revoke any Regulator-imposed penalty would be '*very poor.*'

This case provides some counterpoint to other, recent appeals in which postal difficulties were raised as an excuse. The crucial difference is that there was some evidence (rather than mere assertion) of mail-delivery problems here. Another interesting point of contrast is that the Tribunal has in the past held employers' sudden alacrity in responding to letters showing actual (as opposed to threatened) fines against them. The conclusion drawn in those cases was that it was evidence that correspondence was getting through, with the implication that it was perhaps only when real money was at stake that the letter-opener's attention was properly aroused. Again, the availability of supporting evidence of postal problems seems to have made all the difference.

A dash of consistency (standard-dash-ation?)

The Financial Reporting Council (FRC) has issued an updated version of the *Actuarial Standard Technical Memorandum 1 (AS TM1)* that governs how statutory illustrations for money purchase pensions are undertaken. The updates reflect the need to standardise the calculation methods used to estimate annual retirement income from money purchase benefits ahead of these estimates going live on pensions dashboards.

The updated Standard follows the consultation in February this year and contains prescriptive requirements for setting the accumulation rate of the benefits and the terms on which the fund at retirement is converted to an income.

Accumulation rate

Accumulation rates will be assigned according to the volatility group of the fund, with each fund being allocated to one of four groups depending on the volatility of its monthly investment returns. These returns will be measured over a period of 5 years. As the volatility will be recalculated on an annual basis the corresponding accumulation rates are subject to change throughout the term of the plan, with rates typically reducing as the plan approaches the intended retirement date as a result of de-risking strategies being put in place. Exceptions are included in the standard for cases where fund volatility is more difficult to measure, for example in the case of unquoted assets.

Annuitisation

The estimated annual retirement income will calculated from the total projected pension pot using a single-life, non-increasing annuity. The interest rate for this annuity will be based on the rate on 15 February each year and this same rate must be used for all statutory illustrations occurring in the following financial year. In addition, the pension must include a 5-year guarantee period and no allowance should be made for a lump sum to be paid at the retirement date. As the current level of prescription may not reflect the decumulation options a member could take in the future, the FRC has expressed commitment to work with industry to develop an alternative model that would better reflect these options.

Overall, the changes made to the Standard will ensure consistent estimates of statutory money purchase illustrations (SMPIs) and money purchase retirement income illustrations regardless of the provider. All SMPIs issued on or after 1 October 2023 will be subject to the new Standard, with a further review of the accumulation rates and volatility boundaries expected in 2022/23. By calculating the projections on a consistent basis, it will be simpler for individuals to compare projections from different policies, assess their overall financial situation, and ultimately aid retirement decision making.

The challenge is likely to be in the practicalities of obtaining historical return data from investment managers. However, as the effective date of AS TM1 is October 2023 there is sufficient time for appropriate processes to be developed and put in place ahead of the deadline.

Regulator finalises policies on enforcement activity & prosecutions

The Pensions Regulator has published a new Scheme Management Enforcement Policy, and updated its Prosecution Policy, to illustrate how it expects to use new powers bestowed upon it by the *Pension Schemes Act 2021*. The new policies are discussed in a blog post from the Regulator's Director of Enforcement.

The new policies were the subject of a consultation exercise that operated from May to June 2022. The Regulator has summarised participants' reactions to the proposed guidelines, and the changes that it has made in response, in another document.

For example, the Regulator has resisted suggestions that it should alert targets of potential enforcement action about the decision to open an investigation, saying that, by that stage, it will usually have been in conversation with the parties involved. In some cases, however, it may have concerns about tipping off suspected criminals, which would make a policy of prior notification inappropriate. Neither can it indicate at the outset of an investigation whether it is contemplating a criminal prosecution rather than using its other powers, as that decision is often based on the evidence uncovered as the investigation proceeds. It has, however, clarified that it is unlikely to pursue criminal prosecution for unintentional breaches (unless the pensions legislation takes a strict-liability approach), and does not expect to take action against transferring-scheme trustees in cases involving scams unless they have been involved in wrongdoing.

The Scheme Management Enforcement Policy replaces previously separate procedural guidelines on defined benefit funding, defined contribution schemes and public-service pension schemes.

The policies are a place to look to find out what to expect if (heaven forfend) you ever find that the Regulator's baleful glare has alighted upon you. One extra tidbit from the consultation response document is the statement that the Regulator's second defined benefit funding consultation (with the long-awaited draft Code of Practice) will be published '*shortly*'.

And Finally…

Meet the new boss: same as the old boss?

It is with some trepidation that we put pen to paper (metaphorically) to mark some personnel changes at the Department for Work and Pensions. The original version of this this article had to be amended, amended again, and eventually crumpled into a ball (metaphorically) and re-written. By the time you read this we may be living in an anarcho-syndicalist commune in which the very concept of government ministers is deemed counter-revolutionary (come and see the violence inherent in the system—help, help, I'm being repressed).

At the time of writing, it seems as though the new Pensions Minister might be... the same person who held that role when we published last month's *Current Issues*. Ordinarily, that would be a strange thing to celebrate, but Things have gotten considerably Stranger recently (upside down, you might say).

Guy Opperman was (first) appointed to the role of Minister for Pensions (and Financial Inclusion—don't forget financial inclusion) in June 2017. His remarkably long tenure was interrupted by resignation, in July 2022, as the clamour for Boris Johnson's defenestration neared its crescendo; however, his seat barely had time to cool down before his reappointment, two or three days later. Then, in September, it transpired that he had been '*relieved of* [his] *duties*' on the same day as the death of Her Majesty Queen Elizabeth II, and that the resulting period of national mourning (for Elizabeth, not Guy) had meant that his departure was not made public for another fortnight or so (his removal was perhaps not entirely unrelated to his support for Rishi Sunak over Liz Truss in the campaign to choose Johnson's replacement).

It was widely expected that his replacement would turn out to be Alex Burghart, whose induction into the DWP as Parliamentary Under Secretary of State (the same primary job title held by Opperman) was near-contemporaneous with news of Opperman's dismissal. He had served on the House of Commons Work and Pensions Committee, and could therefore be expected to be familiar with pensions issues. However, his DWP duties were not officially confirmed until around three weeks later, when he was named as the Minister for Pensions (and Growth—don't forget growth). Spoiler alert: we wouldn't have time to find out whether that 'growth' was meant to be economic or personal. Along came the quasi- (sp?) Budget, the resulting loss of trust (sp?) in government debt, a liquidity crisis for DB schemes, emergency measures by the Bank of England, the resignation of one Prime Minister and the investiture of another, and, and, and...

On 27 October it emerged that Opperman was back in the saddle again (he's an amateur jockey, who rode his first win in 1985) at the DWP, this time as a Minister of State rather than Under Assistant West Coast Promotion Man (his re-appointment and promotion perhaps not entirely unrelated to his support for Rishi Sunak over Liz Truss in the campaign to choose Johnson's replacement). Burghart was transferred laterally out of the DWP to become a Parliamentary Secretary in the Cabinet Office. It has not, however, been confirmed that Opperman is The Pensions Guy this time around. Indeed, he gave a rather gnomic reply about planned auto-enrolment reforms—'*In my former life I was very much looking at that specific policy and I am quite sure that the Government will address it shortly*'—that might suggest otherwise. Most of the pensions questions that day were handled instead by his DWP colleague, Laura Trott.

So, fare thee well, Alex, we hardly knew ye; so briefly, in fact, that *AF* never shook off the puerile habit of calling you Mr Burger Hat. Welcome back, Guy; we're sure your DWP colleagues won't want you to return all the leaving presents (will they?). And hello, Laura: perhaps we'll be hearing more from you.

Now: smile and grin at the change all around (if appropriate, pick up your guitar and play, just like yesterday). Then get on your knees and pray…

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