

Q3 2019

Trustee pensions law update

Speed read

Defined benefit (DB) and defined contribution (DC) considerations

- Further investment and disclosure obligations are being imposed on trustees of certain schemes, in particular with regards to information that must be included in the Statement of Investment Principles (**SIP**). *SH comment: In addition to this year's SIP changes, trustees must now make further updates to the SIP by October 2020.*
- The Pensions Regulator (**TPR**) has, for the first time, used its powers to replace trustees primarily because of a lack of competence of the existing trustee board. *SH comment: This re-enforces the new "clearer, quicker, tougher" approach that TPR is taking.*
- The DWP has now launched a consultation on draft regulations that will change the way trustees are required to manage their relationships with their investment consultancy (**IC**) and fiduciary management (**FM**) providers. In particular, they will be required to carry out a tender process before appointing a new FM provider and to set objectives for their IC providers. *SH comment: A stricter tender procedure will need to be followed by trustees caught by these new regulations when they come into force.*

DB considerations

- The Court of Appeal confirms that TPR can take into account facts and circumstances that existed before the financial support direction (**FSD**) regime came into force, when determining whether it is reasonable to impose an FSD. *SH comment: The FSD regime has an element of retrospectivity, but this will not be a significant issue for trustees of on-going schemes in 2019.*
- An industry group has issued guidance on guaranteed minimum pension (**GMP**) equalisation suggesting that trustees should start considering data capture and verification and suggesting approaches to rectification and certain impacted transactions. *SH comment: we expect that most schemes have already taken the actions suggested by the industry working group, but expect more guidance to follow.*

DC considerations

- TPR has updated its investment governance guidance for DC trustees, in part to assist with the new investment and disclosure obligations coming into force later this year. *SH comment: Further DC governance obligations are being imposed on trustees, following a trend of increasing regulation and guidance applying to DC schemes. With this in mind, as well as TPR's stricter approach to enforcing compliance, DC trustees may wish to consider a compliance review to ensure all relevant regulations are being met.*

DB and DC Issues

New obligations on trustees – investment and disclosure

Trustees should be aware of two sets of Regulations published in 2018 and 2019 which impose additional investment and disclosure obligations on trustees of applicable schemes. The table below sets out a high level overview of the main obligations, although please speak to your usual Stephenson Harwood pensions law team contact to find out more about how and if these obligations apply to your scheme and whether any exemptions apply.

Who is affected	What is the change	Timeline
Trustees of occupational DB and DC schemes	The SIP must state how financially material considerations (largely environmental, social and governance matters (ESG)), are taken into account in the selection, retention and realisation of investments.	1 October 2019
	The SIP must include the extent, if at all, to which non-financial matters are taken into account in the selection, retention and realisation of investments.	1 October 2019
	The SIP must include a stewardship policy regarding the exercise of rights attaching to investments and the undertaking of engagement activities in respect of the investments.	1 October 2019
	The SIP must include the trustee's policy regarding its arrangement with its asset manager relating to certain specific areas.	1 October 2020
	The stewardship policy must be expanded to include a statement regarding how the trustee's monitor their investment companies' capital structures, how they manage actual or potential conflicts of interest and how they monitor and engage with other stakeholders.	1 October 2020 to be published on a website by 1 October 2021
Trustees of occupational DC schemes	The SIP must be published on a website.	1 October 2019
	<p>The trustees must draft and publish an implementation statement covering:</p> <ul style="list-style-type: none"> the extent to which the SIP has been followed and any review of the SIP in the year; an explanation of any changes that have been made to the SIP; and the date of the last review of the SIP if a review in the year was not undertaken. 	1 October 2020

	The implementation statement must be extended to include a statement on the voting behaviour by and on behalf of trustees, and must be published on a publicly available website.	To be published by 1 October 2021
Trustees of DB schemes	The SIP must be published on a website.	To be published by 1 October 2020
	The trustees must draft and publish an implementation statement setting out how the trustee's stewardship policy has been followed. The statement must also describe the voting behaviour by or on behalf of the trustees.	To be published by 1 October 2021

TPR replaces trustees who lack knowledge and understanding

The trustees of the Dunnes Stores (Bangor) Limited Management Pension Scheme (the Scheme) have been stopped from running the Scheme by TPR. This follows a catalogue of governance failures by the trustees, including failing to:

- prepare adequate chair's statements;
- comply with statutory charge cap requirements in relation to default investment funds and to properly address the issues arising from that regulatory breach;
- maintain a trustee board consisting of one third member-nominated trustees; and
- follow professional advice obtained in relation to a transfer of Scheme assets.

TPR found that, despite more than a decade of being responsible for running the scheme, the trustees had failed to "familiarise themselves with the requirements of UK pensions legislation" and demonstrated "that they do not have, or are not exercising, their knowledge and understanding for the proper administration of the scheme". This led to a series of governance failures which the trustees did little to rectify, even when TPR became involved.

TPR has now appointed an independent trustee to oversee the Scheme and, ultimately, protect members' benefits. This is the first time TPR has used its power to appoint a trustee primarily because of a lack of competence of the existing trustee board and this reflects TPR's desire to take a clearer, quicker and tougher approach to driving up standards in the pensions sector.

DWP consults on regulations in relation to trustee oversight of investment consultants and fiduciary managers

As reported in our July edition of pensions snapshot, the CMA (Competition and Markets Authority) introduced *The Investment Consultancy and Fiduciary Management Market Investigation Order 2019* in June of this year (the **Order**). The Order was introduced as part of a number of reforms to the IC and FM sector after the CMA found competition problems. It is intended to improve ongoing engagement by pension scheme trustees with their IC and FM providers and lead to improvements in obtaining value for money from IC and FM services.

The DWP has now launched a consultation on draft amending regulations that will integrate the Order into existing pensions law and change the way trustees are required to manage their relationships with their IC and FM providers. Broadly speaking, *The Occupational Pension Schemes (Governance and Registration) (Amendment) Regulations 2019* in their current form would impose the following new requirements on trustees:

- With effect from 6 April 2020, trustees must carry out a "qualifying tender process" (or arrange for such a process to be carried out on their behalf) before:
 - appointing a new FM provider to manage 20% or more of the scheme's "manageable assets";
 - or

- increasing the amount of the scheme's "manageable assets" which are managed by an existing FM provider to 20% or more.

A "qualifying tender process" requires the trustees to (i) invite, and use reasonable endeavours to obtain, bids for the provision of FM services from at least three unconnected FM providers, and (ii) evaluate the bids obtained. A scheme's "manageable assets" are all its assets other than any buy-in policies.

- If, immediately before 6 April 2020, a scheme has one or more existing FM providers in place who (i) manage 20% or more of the scheme's "manageable assets" and (ii) were appointed without a tender, the trustees must carry out a "qualifying tender process" as described above before the end of a five year period beginning with the day on which the earliest of the existing FM provider arrangements commenced. If that five year period expires before the end of 9 June 2021, the date for compliance is 9 June 2021.
- Trustees will also be required to set objectives for their IC providers in respect of the activities the providers carry out. These objectives must normally have regard to the scheme's statement of investment principles and must be reviewed and, if appropriate, revised at least every three years (or without delay if there is any significant change in investment policy). In addition, trustees must review the IC provider's performance against the objectives at least every 12 months.
- The Pensions Regulator (**TPR**) will be tasked with ensuring compliance with the new requirements. Trustees will be required to report compliance to TPR on an annual basis using the scheme return process. TPR will update the scheme return to include questions in relation to the new requirements.

The consultation closes on 2 September 2019 and the DWP intends to lay the final regulations before Parliament in either December 2019 or January 2020. The regulations are expected to come into force with effect from 6 April 2020. However, as things stand, the relevant provisions in the Order will come into force on 10 December 2019. The Order is binding legislation and, as such, trustees should probably ensure they are compliant by this earlier date in order to avoid any potential CMA enforcement action.

TPR is separately consulting on four guides designed to support trustees in meeting the new requirements and engaging with their IC and FM providers. This consultation is due to close on 11 September 2019.

DB issues

TPR's ability to impose a financial support direction includes an element of retrospectivity

The Court of Appeal has upheld an FSD issued by TPR against the ITV Group (**Target**).

The FSD stemmed from a joint venture that ITV set up with Thorn in 2000, often referred to as Box Clever. In 2001, the Box Clever employers established a defined benefit pension scheme for certain employees (the **BC Scheme**). The Box Clever employers subsequently became insolvent, leaving a deficit in the BC Scheme. TPR issued an FSD to the Target requesting financial support for the BC Scheme.

The Target appealed against the FSD on a number of grounds. Of key significance, however, was the Target's argument that the establishment of the joint venture and the BC Scheme, and the factors TPR took into account in deciding that issuing an FSD was reasonable, pre-dated the Pensions Act 2004, which was the legislation that introduced TPR's FSD powers. The Target argued that the FSD legislation was not intended to have retrospective effect.

The Court of Appeal rejected each of the Target's arguments and on the retrospectivity point noted that TPR could take into account facts that existed before the FSD regime existed when determining if it was reasonable to impose an FSD. The Court also confirmed that the Target did not have to be at fault in order to be the subject of an FSD.

As a result, transactions and commercial arrangements that pre-date the Pensions Act 2004 may still be relevant in determining whether it is reasonable for the TPR to impose an FSD. The Court has also reiterated the point that TPR does not need to find there is fault on the part of a target before an FSD can be issued.

Industry Group publishes guidance on GMP equalisation

The cross industry GMP Equalisation Working Group has produced the first in a series of guides to assist those involved in the process of adjusting scheme benefits to counter the inequalities of GMPs between male and female members earned in the period 17 May 1990 to 5 April 1997.

The guide highlights three areas which should be considered now:

GMP Reconciliation

The guide notes that schemes need to consider whether members' benefits should be adjusted to reflect GMP reconciliation or whether such adjustments should wait until GMP equalisation has been undertaken, meaning that an adjustment would only have to be made once.

Schemes should consider which members are impacted by rectification and which will be impacted by GMP equalisation. If there is minimal overlap between the two groups, there may be a stronger case for proceeding with rectification now. Whatever option is chosen, clear member communication will be key.

Data

Data capture and verification will be a key part to a successful GMP equalisation exercise. Trustees should be considering this process now.

Impacted Transactions

These are transactions which may need to be revisited as part of the equalisation project if undertaken before the scheme benefits have been amended to counter the effects of unequal GMPs. Examples include transfers out, trivial commutation and serious ill health lump sums. Consideration should be given as to how to deal with these transactions.

The guidance highlights that if transactions such as transfers out and trivial commutation are to be carried out now making an allowance for GMP equalisation, care needs to be taken to consider the circumstances in which such a calculation may need to be revisited once GMP equalisation has been achieved for the scheme as a whole. Trustees should also ensure that the approach taken to transfers-out does not fetter the choice of equalisation method for the scheme as a whole.

If certain transactions are to proceed on an unequalised basis, consideration should be given as to whether there is a risk tax charges will arise on, for example, a subsequent top-up payment. Whilst delaying certain transactions may be an option, it will not be practicable for serious ill health lump sum payments.

DC issues

TPR updates its investment governance guidance for DC trustees

In response to the changes being introduced to trustee investment and disclosure obligations (discussed earlier in this briefing), TPR has updated its investment governance guidance for DC trustees.

The guidance seeks to offer assistance to trustees when it comes to considering ESG factors in investment strategy. The guidance in particular notes that trustees should understand the systematic risks of climate change in investment decisions in the context of their scheme.

In addition, TPR stresses that trustees must take account of all financially material factors relevant to the performance of investments when considering investments and investment strategy, and provides examples of a number of considerations to take into account.

The guidance also offers advice to trustees on how to approach non-financial considerations and member views, and how trustees can approach their stewardship policy.

The guidance, in addition, touches upon the forthcoming requirements of trustees to tender for fiduciary management services where 20% or more of the scheme's assets will be subject to such management and how trustees can undertake the appointment of a fiduciary manager.

This note does not constitute legal advice. Information contained in this document should not be applied to any particular set of facts without seeking legal advice. Please contact your usual Stephenson Harwood pensions law team member for more information.