

Q2 2020

Pensions law trustee update

Speed read

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

- **COVID 19 and pensions.** The Pensions Regulator (TPR) has produced [guidance](#) in light of the coronavirus providing that trustees should consider requests from sponsors to reduce or suspend Deficit Repair Contributions (DRC). Furthermore, the Chancellor in these unprecedented times has unveiled new measures to help businesses, employees and furlough workers as well as the self-employed with grants in place of up to £2,500. *SH Comment: Keeping track of the latest guidance and measures will be vital for sponsors and trustees. These temporary regulatory easements are welcome, but may pose trustees with difficult decisions for which advice will be needed.*
- **The Pension Schemes Bill 2019-2020 progresses** – As reported in previous trustee updates, the Pension Schemes Bill (the **Bill**) includes proposed extensions to the powers of the Pensions Regulator and introduces new criminal sanctions and civil liability for certain actions. *SH Comment: The details of the Bill as initially introduced were set out in the last quarterly update.*

DB considerations

- **Defined benefit funding code of practice consultation** – TPR has issued the first of its two-stage consultation on the new defined benefit code of practice. This first stage seeks industry views on proposed principles for the funding of defined benefit (DB) schemes. The second stage is expected at the end of the year and will seek opinions on the draft code itself. *SH Comment: Trustees should ensure they are aware of the proposals and may consider making a response. The new code is expected to come into force at the end of 2021.*
- **Pensions Ombudsman follows well established principles in a recoupment of overpayment case.**–The Pensions Ombudsman rejected Mr S's claim against his pension scheme that he did not have to repay an overpayment. One of his arguments was that the six year limitation period applied to recoupment. *SH comment: In rejecting the member's complaint, the Pensions Ombudsman provides further weight to the well-established legal position that the six year limitation period does not apply to the equitable remedy of recoupment and that, where recoupment is sought, the trustees are not limited to a six year look back period.*
- **Pensions Ombudsman finds trustees fettered their discretion in rigidly sticking to ill-health criteria not found in scheme rules.** The trustees rejected an ill health claim relying on strict criteria that were not set out in the rules. *SH Comment: This decision re-iterates the importance of trustees following scheme rules when deciding ill health cases.*

DC considerations

- **Stricter TKU regime on the way.** TPR has responded to its "Future of Trusteeship" consultation which took place in Q3 2019. Notable for trustees are requirements for a stricter trustee knowledge and understanding regime. There will be no mandatory obligation for a professional trustees or indeed sole trusteeship. TPR has however made it clear that they want occupational defined contribution (DC) schemes to consolidate especially where there are governance concerns. *SH Comment: This will be a key area to follow as TPR continues to focus on 21st Century Trusteeship and pressure comes on DC trustees to consolidate stand-alone occupational DC schemes.*

COVID 19 and pensions

TPR Update: Includes Trustee flexibility to reduce or suspend deficit repair contributions (DRCs) for three months

The Pensions Regulator (TPR) has produced further guidance in light of COVID-19 (published on 27 March) for [defined benefit \(DB\) scheme trustees](#), [defined contribution \(DC\) scheme trustees](#), and for [DB sponsors](#).

Requests to reduce or suspend deficit repair contributions (DRCs)

Trustees should consider requests from sponsors to reduce or suspend DRCs (in line with [TPR guidance](#) published on 20 March). Where a sponsor is unable to provide time for trustees to assess the covenant and affordability, to obtain appropriate advice and/or to provide the financial information required, TPR expects any reduction or suspension of DRCs to be no longer than three months. Trustees should ensure that banks and other funders are being supportive and that no dividends or other distributions are being made from the sponsor. Trustees may agree to a longer suspension/reduction period (in line with TPR's 20 March guidance), ideally underwritten by any available protections. Legal and actuarial advice should also be obtained on whether to reduce or suspend DRCs, and on the most appropriate method of doing so.

Completion of scheme valuations

DB schemes that are close to completing their valuations are not expected to revisit their assumptions, although trustees may be advised that it is in the best interests of their members to do so. Post-valuation experience is not required to be taken into account but it should be considered when agreeing recovery plans, and should focus on the affordability of provisionally agreed DRCs for the sponsor.

It may be appropriate in some circumstances for trustees to delay submitting their valuation and associated documents (which may need to be re-negotiated soon) by up to three months, although this may mean trustees fail to meet the 15 month statutory deadline. TPR does not intend to use its power to fine trustees for late submission, but that position will be revisited in three months' time.

Trustees may decide to delay their submission of the recovery plan by up to three months if they need more time to consider the scheme's and sponsor's situation. TPR will not take regulatory action for their failure to submit.

Requests to suspend or reduce payments for future service

As with requests to suspend or reduce DRCs, any member or sponsor who requests to suspend or reduce future service contributions should be treated in the same way, but there are additional issues to consider (e.g. whether this is allowed under the scheme rules). Legal advice on such matters is recommended.

Requests to release security

Trustees should consider carefully any request from a sponsor to release security which is unlikely to be in the members' best interests. Trustees should obtain legal and financial advice if such a request is received.

Investments

In relation to investments, at this uncertain time, trustees should review:

- their scheme's cashflow requirements;
- any specific risks which may now exist within their portfolios or within the sponsor's business;
- any previously agreed investment and risk management decisions due to be implemented in the future; and
- investment governance structures and delegations in the event of trustee incapacity or absence.

An assessment of whether any changes should be made to investment and risk management governance framework should be undertaken.

In its investment guidance for DC schemes, TPR set out recommended trustee considerations to include opportunities to enhance investment or to transfer to a larger, better resourced provider.

Transfer values

At this time of market uncertainty, members could make inappropriate decisions to crystallise losses or be exploited by scams and unscrupulous financial advisers. Trustees should be aware of this heightened risk to members. They may suspend cash equivalent transfer value (CETV) quotations and payments in order to review CETV terms and/or to deal with any administrative impact due to an increased demand in CETV quotes.

Any breach of disclosure requirements will still need to be reported to TPR, but it will not take regulatory action in the next three months against trustees who suspend CETV activity. CETV suspension or delayed quotations can continue if it is still in the best interests of members but trustees should be clear on the reasons to do so and notify TPR.

TPR will take a reasonable, pragmatic and proportionate approach to its regulation of schemes in the weeks and months ahead.

Full guidance can be found here: [Defined Benefit \(DB\) scheme funding and investment](#), [Defined Contribution \(DC\) investment](#) and [DB scheme funding: COVID-19 guidance for employers](#).

Scheme administration

The impact of Covid-19 on pension schemes will be impacting administration and other services but trustees will want to ensure members are being paid on time. Member payments must continue to be made promptly and where applicable, in accordance with statutory timeframes. Late payments due to staff absences due to illness or lockdown could risk future claims being brought by members. As such, it is vital that trustees engage with all service providers and advisers now to understand the business continuity plans that are in place and who should be contacted if the usual staff contacts are unavailable.

Trustee boards

An effective trustee plan should be put in place to deal with any issues that may arise from fellow trustees were they to be unwell, or competing pressures and now with the social distancing guidelines. It will be crucial to keep on top of these issues which could lead to meetings being attended inquorate or with delays. Trustees should therefore check the scheme's trust deed and rules (and articles of association for a corporate trustee) to see whether trustee meetings can be held remotely. Business plans should be reviewed to identify priority actions in the next few months such as valuations and accounting deadlines. Trustees may also want to review any liability insurance that may be in place to see if this assists in the current uncertain situation.

Bulk annuities

Deals could take longer given the pricing uncertainty currently out in the market. There may be opportunities but there may also be challenges. Insurer ratings are being downgraded and therefore if trustees are considering this option, it may now be more important to obtain insurer covenant reports. Therefore, trustees should keep the channels of communication open with their consultants about the impact on any ongoing or planned bulk annuity transaction.

Auto-enrolment and the current position of TPR

Employers have a legal duty to make automatic enrolment contributions for their qualifying employees, and it would need a change in legislation to remove this. The law has not been changed to permit employers to reduce pension contributions in relation to their jobholders below the automatic enrolment minimum level, or to cease or suspend contributions and TPR has not announced any relaxation of its

automatic enrolment enforcement regime. Therefore, any such reduction or suspension would be a technical breach of automatic enrolment regulations and might result in TPR using its enforcement powers (including fines and public censure).

Furlough workers

This measure was introduced on 20 March 2020 by the Chancellor to help businesses during the economic crisis created by the coronavirus.

Officially, it is called the Coronavirus Job Retention Scheme (or “furlough leave”) which is a temporary leave of absence for economic reasons and is designed to save jobs but where the government will step in and cover up to 80% of pay up to a maximum £2500 per month. The Government issued [guidance](#) which provided confirmation on 26 March 2020 that:

“All employers remain liable for associated Employer National Insurance contributions and minimum automatic enrolment employer pension contributions on behalf of their furloughed employees”.

It further confirmed that employers who are eligible to claim under the Coronavirus Job Retention Scheme can:

“claim a grant from HMRC to cover wages for a furloughed employee, equal to the lower of 80% of an employee’s regular salary or £2,500 per month, plus the associated Employer National Insurance contributions and minimum automatic enrolment pension contributions on paying those wages.”

DB and DC Issues

The Pension Schemes Bill 2020 progresses

The Pension Schemes Bill 2019-21 (previously named The Pension Schemes Bill 2019-2020) has now had its first and second sittings of the House of Lords Parliamentary committee stage at which further information was sought and amendments were proposed. Please see the previous quarterly update for more details.

DB Considerations

Defined Benefit funding Code of Practice Consultation

In TPR’s white paper “Protecting Defined Benefit Pension Schemes”, the government noted the DB funding framework is working on the whole, as intended. However, there was also an acknowledgment that there was room for improvement in key areas such as:

- the need for greater transparency and accountability around the risks being taken on behalf of members; and employers; and
- for trustees to focus on the long-term strategic issues of their scheme as the landscape matures.

In addition to the above, DB trustees also need to set their scheme’s Technical Provisions (**TPs**) prudently and set out an appropriate Recovery Plan (RP).

TPR are, therefore, consulting on a revised DB funding code. This consultation is taking place in two parts:

- The first consultation considers the new proposed regulatory approach and will contain the core principles underpinning the framework. The second consultation, planned for later in 2020 (as at the time of publishing) will seek views on the draft code itself. This will be informed by industry feedback to the current consultation, TPRs impact assessment and the changes to key legislation such as the Pensions Schemes Bill and regulations.

TPR are proposing, a twin-track route to carrying out valuations (which will be referred to as "Fast Track" and "Bespoke"). For schemes that meet TPRs guidelines for a compliant scheme, they will be able to use the straightforward, prescriptive 'fast track' approach. For other schemes, they will follow the bespoke route.

Key themes underpinning the consultation include:

Long-term planning

- The Pensions Schemes Bill will introduce requirements for trustees to set a funding and investment strategy (described as "long-term objective" (LTO)) where trustees are expected to set a prudent journey plans.

Employer covenant

- The consultation is considering on the extent to which the employer covenant should remain a key aspect of scheme funding, including how it should be assessed and for how long can it be relied on.

Investment risk

- TPR expects a level of investment risk that is supportable and have set out proposals for trustees to demonstrate whether the risk in their investment strategy is supported.

Recovery plans

- Where funding shortfalls arises, there should be an appropriate recovery plan which considers employer affordability. By doing this, parties can work out the appropriate length and structure of the recovery plan.

Open schemes

- TPR are consulting on the framework that should apply for open schemes but notes members' accrued benefits should have the same level of security as accrued benefits in closed schemes.

The hope is that the new framework will not be too onerous but will help create a sustainable framework providing the right balance between the security of member benefits and the costs to employers of running their DB schemes. The focus is very much on scheme-specific approaches, rather than a one-size fits all mentality.

Pensions Ombudsman follows well established principles in a recoupment of overpayment case

In the recent case of Dr S (PO-22315), the Pensions Ombudsman rejected a complaint that the USS Pension Scheme (**Scheme**) could not recoup a mistaken overpayment from future pension instalments. The overpayment arose due to a miscalculation of extra service contributions paid after Dr S had reached maximum pensionable service in the Scheme. Dr S brought his complaint on several grounds, including:

- A "change of position" defence to the recovery of the overpayment because he had used the overpayment to renovate his kitchen and gift money to his daughter, so the money could not be recovered.
- If the Ombudsman did not agree that Dr S had a defence to recovery, then the Scheme was only able to claim back that part of the overpayment which fell within a six year limitation period under the Limitation Act 1980. Dr S said that this was because:
 - The case of *Burgess v BIC UK Ltd* (which found that recouping overpayments from future pension payments was an equitable remedy and not subject to the six year limitation period) did not apply because it concerned different facts. Burgess concerned repayments from pensioners in order to make an adjustment to the fund as a whole, rather than individual overpayments. In addition, the judge's comments in *Burgess* about the six year limitation

period not applying to recoupment were made 'obiter', i.e. they were not intended to set a precedent. Dr S said this meant that Burgess was not relevant to his case.

- In other cases, the Ombudsman had applied *Webber v Department for Education* to find that overpayments were subject to a six year limitation period.
- In any event, the Scheme could not recoup the overpayment from Dr S's pension instalments because the overpayment was in dispute, and this meant that the Scheme was required under section 91 of the Pensions Act 1995 to obtain an order of a "competent court", upholding the legitimacy of the overpayment, before deductions could be made from Dr S's pension. Dr S said that the Scheme had not done this.

In dismissing the complaint, the Ombudsman found that:

- Dr S did not have a defence to recovery of the overpayment. This was in part because the difference between the overpayment and the correct pension payment was relatively small (4%), and Dr S had spent a much larger amount on his kitchen and gifts to his daughter. Dr S would probably have acted in the same way had he received the correct benefits at retirement.
- It is an established legal position that the six year limitation period does not apply to the equitable remedy of recoupment. This was the position before Burgess, and Burgess merely restated it. *Webber* concerned repayment rather than recoupment out of future income, so was not relevant. The Limitation Act 1980 therefore did not prevent the USS from recouping the entire overpayment.
- A determination by the Ombudsman upholding the legitimacy of an overpayment is an order of a competent court for the purposes of section 91 of the Pensions Act 1995. This is in line with the Ombudsman's April 2019 statement on this issue (which we discussed in the May 2019 edition of Snapshot). Section 91 therefore did not prevent the Scheme from making deductions from Dr S's pension to recoup the overpayment.

Dr S was required to repay the full overpayment, but was awarded £750 in respect of maladministration by the Scheme.

[Pensions Ombudsman case: Trustees fettered their discretion in rigidly sticking to ill-health criteria not found in scheme rules, to deny pension](#)

In this case, Mr S was suffering from MS and applied for an ill-health early retirement pension from his scheme. He was initially refused this on the basis that his pension constituted pre-1988 GMP and this could not be reduced (an early retirement pension on grounds of ill-health would otherwise be subject to reduction from the scheme). It was subsequently ascertained that the trustees of the scheme had a discretion to waive the reduction for early payment of pension where the member was able to prove 'serious ill-health'.

The meaning of 'serious ill-health' was not defined in the rules with the trustees instead using grading criteria with 'Grade 5' medical incapacity being the grade at which they would exercise their discretion to pay an ill-health pension unreduced. In this case the trustees decided that the member did not meet the requirements for 'Grade 5' medical incapacity.

The Ombudsman held that the trustees had fettered their discretion by rigidly sticking to the grading criteria which was not written into the rules (i.e. the rules read alone would have given them more flexibility and potentially allowed them to exercise the discretion to pay the pension unreduced). This constituted maladministration and the Ombudsman directed the Trustees to review their decision and consider the exercise of their discretion properly without the constraint of this grading criteria.

The case highlights that trustees should be careful not to fetter their discretion when applying policies rigidly which do not otherwise form part of their scheme rules.

DC Considerations

Future of trusteeship consultation response: stricter TKU regime on the way

The Pensions Regulator (**TPR**) has responded to its "Future of Trusteeship" consultation which took place during Q3 2019. Here is what trustees need to know.

1. Stricter trustee knowledge and understanding regime

As part of TPR's overhaul and consolidation of its Codes of Practice over the next year or so, TPR will be modifying the trustee knowledge and understanding (**TKU**) elements and supporting guidance, with updated requirements on TKU and overall trustee competence.

TPR has signalled that it will expect lay trustees to have at least 15 hours of ongoing learning and for a higher 25 hour requirement to apply to professional trustees. Furthermore, once its new TKU materials have been in place for a "reasonable period", TPR intends to quiz all trustee boards actively (presumably via a questionnaire) on how they are complying with the updated TKU and trustee competence requirements. TPR will then engage directly with trustee boards whose responses miss the mark.

2. No mandatory professional trustee

The most controversial idea floated by TPR in the consultation was a mandatory requirement for schemes to appoint an accredited professional trustee. The consultation response indicates that this received broadly negative feedback. For now at least, TPR has dropped the idea.

3. Sole trusteeship

TPR indicated some concerns with independent trusteeship models in the consultation, such as anecdotal evidence that employers might be replacing trustee boards with a sole trustee to achieve employer-friendly scheme funding arrangements. In the consultation response, TPR does not reach any firm conclusion on the matter, noting that it continues to have concerns particularly around how effective certain sole trusteeship models are at dealing with conflict issues and ensuring member engagement. As a result, TPR will be carrying out separate research on the sole trusteeship market to determine if any regulatory reforms are needed.

4. Diversity

TPR does not intend to introduce a requirement for schemes to report on diversity and inclusion matters (for now) but TPR will raise the profile of diversity and inclusion matters for trustee boards by establishing and chairing an industry-wide working group.

5. DC consolidation

TPR has made clear its aim for occupational DC schemes to consolidate; particularly smaller schemes where it has general governance concerns. The difficulty with this is forcing consolidation for DC schemes that contain guarantees (such as schemes invested in with-profits funds). The consultation response does not reach any firm landing on surmounting that difficulty but hints that TPR and DWP may be investigating how to force insurers to assign guaranteed investment policies.

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