CLIFFORD CHANCE

UK PENSIONS UPDATE: JUNE 2022

1. RECENT EXERCISES OF TPR'S POWERS

ITV, Box Clever – Contribution Notices

In May, the Pensions Regulator ("**tPR**") issued a warning notice seeking contribution notices ("**CN**"s) against ITV and four related entities in relation to the Box Clever Group Pension Scheme (the "**Scheme**") for £133m (the buy-out deficit as at 30 April 2020 is understood to have been estimated at £110m). This follows the long-running anti-avoidance case in which ITV lost its legal challenge against tPR's issue of Financial Support Directions ("**FSDs**") to five ITV companies. ITV had been given a six-month deadline to provide financial support for the Scheme which should have been put in place in 2020. While ITV has made offers of support for the Scheme (initially £32m increased to £52m), these were not accepted by tPR.

SMT Scharf AG – Contribution Notices

Earlier this year tPR published a regulatory intervention report confirming the use of its anti-avoidance powers against SMT Scharf AG, a German mining equipment business with global interests and subsidiaries, in support of the scheme for the employees of the Dosco Group, a UK-based engineering business which had been sold by way of management buy-out ("**MBO**") to a shell acquisition vehicle with no assets or investors. A CN was issued for £2m, inclusive of additional sums awarded for lost investment returns and interest (for the first time) on the grounds that the buyout had a material detrimental effect to the scheme. A financial settlement of £130,000 was also secured with a former Chief Executive of the Dosco Group, Martin Cain who had led the MBO, reflecting the payment he had received for implementing the MBO. The amounts were quite modest versus the estimated £38.8m buy-out deficit at the time of the MBO.

Norton Motorcycles – Employer-related investment breach

Earlier this year and in a rare exercise of its powers regarding employer-related investment restrictions, a prosecution by tPR resulted in the former trustee of the Norton Motorcycles pension schemes being sentenced to eight months imprisonment, suspended for two years, for investing more than 5% of the scheme funds in return for preference shares in Norton Motorcycle Holdings Ltd.

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Pension Liberation Scam

In April, tPR announced the conclusion of its successful prosecution of two former trustees for their involvement in a £13.7 million pension scam carried out between 2012 and 2014. The former trustees received prison sentences of five years and seven months and four years and eight months respectively.

2. TPR CONSULTS ON CONSOLIDATED AND SIMPLIFIED ENFORCEMENT POLICY AND UPDATED PROSECUTION POLICY

On 4 May tPR published for consultation a new, consolidated and simpler draft enforcement policy which consolidates previous policies on defined benefit ("**DB**") funding regulatory and enforcement, defined contribution ("**DC**") compliance and

enforcement, and public sector pension schemes compliance and enforcement. The idea behind the consolidation and simplification is to combine all of the enforcement related content in one place, with clear links through to other relevant policies and procedures to make it easier to access and understand. TPR has also updated its prosecution policy which sets out how tPR will approach the prosecution of workplace pension criminal offences (e.g. failure to comply with automatic enrolment duties / conduct risking accrued scheme benefits) and other types of offences that form part of its remit (e.g. fraud / money laundering).

The consolidation and simplification come following increasing pressure on tPR to clarify how it will investigate and approach prosecution of certain criminal offences in light of the Pension Schemes Act 2021 (the "**PSA 21**") which, in particular, grants tPR broad powers to impose liability (including criminal liability) on persons and entities connected with UK pension schemes where their conduct puts members' pensions at risk. TPR's criminal offences policy was published in September 2021[1], and a link to that policy is provided in the draft prosecution policy.

TPR has also published two new high fines policies for its avoidance powers and information requirements powers, alongside a response document to last year's consultation on new policies regarding overlapping powers, monetary penalty powers and information gathering. TPR's approach to overlapping powers and information gathering is now incorporated as chapters in the draft enforcement policy. Broadly, while the guidance on overlapping powers includes some helpful examples to illustrate the types of factors that may lead tPR towards a particular power (in the context of prosecuting employer-related investment breaches, issuing contribution notices and in exercising information gathering powers), ultimately tPR is clear in its response that the choice of power it pursues will very much depend on the individual facts of the case.

3. TPR GUIDANCE: CONFLICT IN UKRAINE

TPR's guidance setting out its expectations for schemes with regards to the ongoing conflict in Ukraine remains relevant for trustees and employers as the sanctions on Russia continue to develop and change over time. Trustees and employers will need to have regard to the guidance from the Financial Conduct Authority ("**FCA**") to ensure they meet the requirements on entities that are subject to sanctions, or connected to sanctioned entities. While acknowledging the difficulties in disposing of Russian assets, the guidance sets out areas it expects schemes to consider:

- For DB schemes, the impact on short-term liquidity and meeting payments;
- Impacts on scheme employers and/or sponsors, both directly and more broadly in terms of suppliers and customers, inflation, fuel prices, currency exchange rates, etc;
- Effects on investments, highlighting short/medium-term risks;
- Cyber safety and related measures in light of increased risk of cyber-attacks and financial crime; and
- Investments' ESG compliance.

Amid the current uncertainty, tPR encourages consideration of the long-term nature of pension investments and cautions trustees against hasty, uninformed portfolio management decisions.

4. TPR AND FCA FEEDBACK ON VALUE FOR MONEY DISCUSSION PAPER

TPR and the FCA have confirmed plans to develop common measurements which will allow industry professionals and pension savers to better compare DC schemes so they can see which offers more value for money ("**VFM**"). This follows the joint discussion paper issued in September 2021 (see our UK: Pensions Update – January 2022 for background), in which tPR and the FCA set out proposals for greater transparency around the three key areas of investment performance, customer service and scheme oversight, and costs and charges. Currently tPR and the FCA are focussed on workplace pension schemes and specifically default arrangements, but the intention is for the VFM framework to be extended more widely to self-select options in workplace and non-workplace pension schemes.

Responses to the discussion paper generally agreed that a holistic approach to assessing VFM was needed (i.e. not just a focus on costs and charges), but feedback on benchmarking VFM elements separately, was mixed. There was also a consensus on consistent disclosure of performance metrics as a necessary tool to enable better VFM assessment, although respondents also emphasised that the approach to disclosure must take into account the intended audience. In addition, concerns were raised regarding setting minimum standards for customer service, given it may only motivate pension providers to provide the minimum. In practice, tPR acknowledges that further work is needed to determine the appropriate

[1] See our UK: Pensions Update – March 2021 for background details on the consultation for the new policy.

framework for transparency in the three areas identified and has indicated that a consultation will be published towards the end of this year setting out proposals.

5. CDC SCHEMES: TPR CONSULTATION AND DRAFT REGULATIONS

Subject to parliamentary approval, regulations[2] on collective defined contribution ("**CDC**") schemes will come into force on 1 August 2022 (the "**CDC Regs**"). The CDC Regs follow the introduction of an "authorisation and supervision regime" under the PSA 21, which permits only appropriately managed CDC schemes to operate and allows tPR to intervene if necessary (for example, where tPR is no longer satisfied that a CDC scheme meets the authorisation criteria it may take regulatory action, including de-authorising it). CDC schemes are intended as an alternative to the current UK pensions market options by using economies of scale to permit greater investment in potentially higher-returning assets than standard DC schemes tend to be able to access.

In the meantime, in accordance with its statutory duty, tPR has consulted on a draft code of practice for the authorisation and supervision of CDC schemes, to provide trustees with clarity on how to apply for authorisation and the criteria tPR expects prospective schemes to meet (the consultation closed on 22 March 2022).

6. DWP CONTINUES DRIVE TO PROTECT MEMBERS' DC BENEFITS AND FACILITATE INVESTMENT IN ILLIQUID ASSETS

In addition to the steps being taken by tPR and the FCA in the DC arena, the Department for Work and Pensions ("**DWP**") is continuing its drive to ensure that savers' contributions are well invested and their savings are not eroded by high costs and charges through various other avenues. In March, the DWP published a combined consultation paper and response to consultation titled "Facilitating investment in illiquid assets by defined contribution pension schemes". This paper is structured in several parts, with notable points including:

Topic	Proposal	Feedback/Next Steps
Response to consultation on exempting performance fees from the DC charge cap	Broadly, the cap currently prevents schemes from imposing charges of more than 0.75% annually on a member's pot. However, there are some charges which are excluded and therefore not covered by the cap. In its consultation in November 2021, the government has proposed to exempt from the charge cap well-designed performance fees that are paid when an asset manager exceeds pre-determined performance targets, in a bid to promote greater pension scheme investment in illiquid assets.	The proposal received mixed reactions from stakeholders and so while the government will press ahead with its proposals, the response notes that it will explore how the concerns raised might be addressed in the design of the policy (for example, careful consideration will be given to aspects such as how disclosure of the right information on the performance fees being charged might be achieved). The government intends to consult on principle-based draft guidance alongside any consultation on draft regulations to effect the exemption, but no timeline for follow-up consultations has been suggested.
Consultation on new 'Disclose and Explain' proposals	The government is proposing that relevant DC schemes will need to disclose and explain their policies on illiquid investment in the Statement of Investment Principles ("**SIP**"). Default asset allocation would also have to be disclosed in the annual Chair's Statement for DC schemes with over £100m in total assets.	The proposals aim to encourage pension schemes to further diversify and invest in assets that bring higher returns. Broadly, the consultation: • proposes two options for the definition of illiquid assets (i.e. at the fund/vehicle level or at the more granular asset level); • sets out the matters it would like the SIP to reference (including, for example, a description of what illiquid assets are, whether trustees choose to invest in illiquid assets and the factors trustees consider when deciding to invest in illiquid assets); and

[2] The Occupational Pension Schemes (Collective Money Purchase Schemes) Regulations 2022.

Topic	Proposal	Feedback/Next Steps
		• proposes that DC schemes managing over £100m in scheme assets be required to publicly disclose in their annual Chair's Statement their default asset allocations in each of the seven main asset classes: cash, bonds, listed equities, private equity (including venture capital and growth equity), property, infrastructure and private debt. The government proposes to issue guidance to describe the way in which it proposes trustees should disclose this information, and issues such as age-specific disclosures, averaging and presentation would be addressed in guidance rather than being hardcoded in regulations.
Consultation on ERI regulation amendments for master trusts	Broadly, employer-related investment ("**ERI**") restrictions impact master trusts given the multiple participating employers which requires greater time and money spent ensuring compliance and may operate to restrict the asset classes in which master trusts can invest. The government is proposing to amend legislation so that restrictions on ERI will only apply to investment in the master trust funder, strategist and persons associated or connected with them where the master trust has 500 or more participating employers.	The aim of the proposals is to update ERI restrictions in reflection of the fact that the pensions landscape has developed since the introduction of ERI restrictions and that it was designed for multi-employer schemes in which employers were connected or part of the same group of companies, such that they might be able to influence investment policies and strategy and approach. The consultation proposes that: • ERI restrictions would only apply to investments in the scheme funder, strategist or persons associated or connected to them where the master trust is authorised and has 500 or more participating employers. Note that this still has the potential to catch a wide number of entities including participating employers where they pay towards scheme costs; • Where the number of participating employers falls below 500, there would be a 2 year transitional period before the master trust would no longer be eligible for this amendment; • Where authorisation is lost, the master trust will similarly have 2 years to bring scheme investments back within ERI limits; • If legal or contractual reasons mean investments cannot be divested, master trusts will be allowed to retain those investments but only until the earliest date on which they are able to disinvest.
Response to the "Future of the defined contribution market" call for evidence	As part of driving value for members' outcomes in summer 2021 the DWP ran a call for evidence regarding DC consolidation and challenging schemes with less than £100m in assets to prove they offer comparable value to larger schemes.	The government will not be introducing any new regulatory requirements with the sole purpose of consolidating the market in 2022. The government will instead work closely with tPR and the FCA on the VFM initiative discussed above.

7. GMP CONVERSION BILL RECEIVES ROYAL ASSENT

Legislation[3] introduced by way of a private members bill on the conversion of guaranteed minimum pensions ("**GMPs**") received royal assent on 28 April 2022 (the "**GMP Act**"). Amendments made by the GMP Act make technical changes to existing pension legislation regarding conversion of GMPs to ordinary scheme benefits to, broadly:

- clarify that conversion applies to survivors as well as earners;
- ensure that any money purchase benefits accrued as a part of members' benefits are not included in the actuarial calculation to convert GMPs into other benefits;
- require that the converted scheme provides benefits to or in respect of any widow, widower or surviving civil partner of the earner and meets further conditions as may be prescribed in regulations in relation to those benefits;
- remove the requirement for employer consent to GMP conversion (this has caused issues in practice where employers of deferred/ pensioner members were no longer around) and instead provide for a power to set out in regulations details about who must consent to the conversion; and
- remove the requirement to notify HMRC of a conversion.

8. SUPPLEMENTARY HMRC GUIDANCE ON GMP EQUALISATION AND CONVERSION

HMRC's April newsletter contains additional guidance on GMP equalisation, supplementing guidance previously published in its newsletters of February 2020 and July 2020. The April newsletter clarifies how corrective payments work where scheme administrators are required to top-up underpaid transfer payments that have previously been made (i.e. payments which were not appropriately adjusted in order to eliminate GMP inequalities), and the tax implications of these payments.

HMRC has also provided limited guidance on the tax implications of GMP conversion as a method of equalisation, although it notes that the issues are "complex" and its work on them is continuing, with further updates intended in future newsletters. Some key points to note on GMP conversion include:

- Where members have not yet retired, in the year of conversion, the removal of the GMP rules may cause the loss of the deferred member carve-out (due to the conversion resulting in a pension input calculation for the conversion tax year and subsequent tax years). HMRC is undertaking further work in this area to examine the potential for legislative change as part of determining the appropriate outcomes for and treatments of such members.
- Conversion may also cause deferred members to lose their fixed income protection due to the increase in member benefits. HMRC has advised schemes to "consider the tax implications that may arise for these members" when they consider using this method.

	Annual allowance	Lifetime allowance
Existing pensioner members (where their pension is already in payment)	No impact; conversion does not constitute benefit accrual and so there is no pension input amount.	Conversion may result in a benefit crystallisation event if it involves "an immediate jump in pension rate". This would need to be quantified by comparison to the levels of payment deemed to be in payment since retirement but after adjustment for the application of a dual record equalisation method (applied in order to calculate arrears due and any restatement of past lifetime allowance usage). Conversion does not trigger the loss of a member's fixed protection from the lifetime allowance charge if all benefits have been crystallised.
Recently retired pensioner members (where	No impact; as above (even if the increase as a result of conversion triggers a BCE3). The member's deferred member carve-out from the annual allowance will continue to	Where the rate of payment of a crystallised pension is increased due to conversion, this may result in a BCE3 benefit crystallisation event. To assess whether the increase does trigger BCE3, the assessment should occur against the level of pension deemed to be in

[3] The Pension Schemes (Conversion of Guaranteed Minimum Pensions) Act 2022

	Annual allowance	Lifetime allowance
conversion occurs after retirement but in same tax year)	apply unaffected as long as it applied to them in the period up until the crystallisation of their benefits at retirement	payment pre-conversion (and on which the member's retirement BCEs would have been assessed or re-assessed), as this should reflect the dual record equalisation method applied to calculate arrears due / any restatement of past lifetime allowance usage.
Members who left pensionable service pre 6 April 2006	No impact of conversion provided the member has, since the agreement under which they became a deferred member, remained outside the annual allowance provisions under that agreement (and provided that their new benefit is actuarially equivalent to their pre-conversion benefit)	N/A

9. PRA STATEMENT ON CAPITAL ARBITRAGE TRANSACTIONS

In April, the Prudential Regulation Authority ("**PRA**") issued a statement on its approach to capital arbitrage transactions, highlighting that firms should not engage in transactions that have the aim of offsetting regulatory adjustments. The statement notes that the PRA is aware of some regulated firms having conducted deficit reduction transactions with their DB schemes that are structured to limit the regulatory capital impact that would otherwise result. The PRA notes that such transactions pose a number of risks, including that they can:

- be complex, artificial, and opaque;
- include legal risk and be untested in their ability to fully address the underlying rationale for the regulatory adjustment;
- have the effect of overestimating eligible capital or reducing capital requirements, without commensurately reducing the risk in the financial system, thus undermining the calibration of minimum regulatory capital requirements.

The PRA encourages regulated firms to be mindful of the compatibility of such transactions with the firm's obligations under the PRA's Fundamental Rules. In particular the PRA notes that its policies should be followed "in line with their spirit and intended outcome, not managing the business only to the letter, or gaming the rules" and signposts that it will carefully scrutinise transactions.

Where any existing transactions are to be unwound, the PRA will look to agree with firms a reasonable timeline to achieve this.

10. PENSIONS OMBUDSMAN DETERMINATION – MRS G

Mrs G (PO-27022) - Teachers' Pension Scheme: scheme recovery of overpayments successful despite maladministration

In error, Mrs G was awarded an additional c.27 years' pensionable service under the scheme, receiving an overpayment of £96,000 over broadly three years. On receiving the erroneous benefit statements prior to her pension being put into payment, Mrs G had made several enquiries of the scheme and her employer to notify them that she believed there to have been a mistake and her benefits to have been overstated, but her queries were not resolved by the scheme and her pension was put into payment on the incorrect basis. Upon the scheme subsequently identifying the error and seeking recovery, Mrs G sought to argue that it would be inequitable for her to repay the overpaid amounts, as she had changed her position (by gifting money to her son, buying a new car, replacing her kitchen and taking holidays that she otherwise would not have done) and had acted in good faith in attempting to investigate the incorrect benefit statements she had received.

Despite Mrs G acting in good faith in investigating the matter, and notwithstanding the material failures and delays in the scheme in adequately investigating Mrs G's pension calculation concerns (which amounted to maladministration), the Pensions Ombudsman ("**tPO**") found that Mrs G had not acted in good faith at the point the overpayment was spent. TPO noted that where there is bad faith, the defence of change of position is not available: importantly bad faith is not synonymous with dishonesty and can arise where a person had reason to believe that the money was being paid in error (even where it was only a suspicion of error) and spends the money anyway. In practice, tPO held that it wasn't reasonable for Mrs G to have considered her enquiries to be resolved given the material differences between her earlier correct benefit statements

and the incorrect ones. In short, tPO did not believe that at any time Mrs G was actually persuaded that the figures she had been provided with were correct. The scheme was entitled to recover the full amount.

Complaints about recovery of overpayments are frequently made to tPO and members typically seek to argue change of position as a defence. This case is another example of the high bar for retaining overpayments and reinforces the legal position that members are only entitled to receive benefits in accordance with the trust and deed rules of the scheme.

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