ALLEN & OVERY

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Pensions: what's new this week

Welcome to your weekly update from the Allen & Overy Pensions team, bringing you up to speed on all the latest legal and regulatory developments in the world of occupational pensions.

DC consultation: illiquid investments, consolidation | Master trust fined for contributions failures | Update: EMIR clearing exemption | PPF levy ceiling and compensation cap 2019/20 | Master trust update

DC consultation: illiquid investments, consolidation

The government is consulting on a range of proposals affecting DC schemes (and hybrid schemes except where the only DC benefits are AVCs). The proposals include:

- **Requirement to report on investment in illiquid assets**: the consultation includes two proposals in relation to illiquid assets (that is, those that are traded off-exchange or are less readily tradeable): first, a requirement for relevant schemes above a set threshold (potentially as low as either GBP250 million in DC assets or 5,000 members) to state their policy on investing in this asset type in the Statement of Investment Principles (SIP), and potentially also in the default fund SIP; and secondly, a requirement to report annually on compliance with that policy. Reporting would be via an annual implementation statement and would include details such as the approximate percentage held in illiquid assets in default funds.
- **Encouraging smaller DC schemes to consolidate, plus reporting requirements**: the government is seeking input on whether it should encourage smaller DC schemes to consolidate (in light of generally lower standards of governance in small DC schemes and greater investment opportunities available to larger schemes).

  It also proposes that smaller schemes should be required to report on whether it might be in members' interests to transfer to another scheme (for example, to a master trust) – this could apply to relevant schemes below a threshold of GBP10 million in DC member assets or 1,000 members). Schemes could be required to publish the assessment annually in the value for members section of the Chair's statement, but the explanation would not necessarily need to be updated annually. Instead, an assessment should be conducted at least every three years (or after a significant change in scheme membership).
- **Changes to the charge cap**: the government is investigating the extent to which the default fund charge cap could be a barrier to investing in illiquid assets, and is considering extending the methods of charge cap assessment to allow for performance fees alongside a 'funds under management' charge (but not alongside contribution charges or flat fees). To read more about the charge cap, click here and here. The government has also asked for input on the content of future (potentially statutory) guidance.

In addition, the government is consulting on other changes to the existing charge cap guidance, including an updated (non-exhaustive) list of included/excluded costs and charges reflecting its policy intent, with clarification in relation to fund types, costs incurred by investee firms or by holding physical assets, and private equity costs.

The government plans to issue further guidance on costs and charges later this year, and is due to review the range of permitted charging structures in 2020.

The consultation closes on 1 April 2019.

Master trust fined for contributions failures

The Pensions Regulator (TPR) has fined the corporate trustee of a master trust GBP50,000 for failing to process core transactions promptly and accurately, and GBP20,000 for failing to keep some members properly informed about unpaid contributions. In October 2018, we reported on the first fine TPR issued in relation to the obligation to process core financial transactions promptly and accurately, which was also in relation to a master trust (see WNTW, 15 October 2018).

In this case, employee contributions had been deducted from salaries but employee and employer contributions had not been collected from multiple employers – TPR was first notified of this large-scale issue several years ago. TPR issued an Improvement Notice to the trustee and a Third Party Notice to the founder (NPL) setting out various steps (with deadlines), including migrating members to a new auto-enrolment software platform and resolving the contributions backlog. NPL will also make good investment losses to members and provide compensation for losses to member benefits due to employer insolvency, if the losses have been clearly caused by NPL.

Update: EMIR clearing exemption

A further extension of the pension scheme exemption from clearing requirements for certain over-the-counter derivatives is now one step closer, following a recent agreement between the European Council and the European Parliament.

Previously, pension schemes benefited from a temporary exemption from the clearing requirements under the European Market Infrastructure Regulation (EMIR), which has now expired. However, the intention was to provide for a further extension under EMIR Refit. The Financial Conduct Authority has previously confirmed that, until further notice, it would not require pension schemes or their counterparties to clear derivatives subject to the exemption during the timing gap.

EMIR Refit has not yet been enacted but, following recent developments, is now expected to be agreed in the coming weeks, including a further extension of the exemption by at least two years.

However, the current uncertainty surrounding the UK's withdrawal from the EU raises a number of issues, including how UK pension schemes will be treated following exit day (29 March 2019). The main UK legislation onshoring EMIR (in the event of a 'no deal' Brexit) has been laid before Parliament for approval (for more information, click here). Trustees should seek legal and investment advice as appropriate – please contact your usual A&O adviser if you need assistance.

PPF levy ceiling and compensation cap 2019/20

The latest Pension Protection Fund (PPF) order sets the levy ceiling at GBP1,058,176,617, and the compensation cap at GBP40,020.34 for the year starting 1 April 2019. The PPF has also published updated compensation cap factors (effective from 1 April 2019).

The 2018 decision of the Court of Justice of the European Union in *Hampshire* that EU law requires compensation for each eligible member to be equivalent to at least 50% of the value of his or her accrued entitlement (see WNTW, 10 September 2018). The PPF has previously announced its interim approach to implementing the decision, subject to future legislation or further court rulings on the issue (the judgment from Court of Appeal in the *Hampshire* case, following the CJEU decision, is expected shortly).

The explanatory memorandum to the order reiterates that the government intends to legislate at the earliest opportunity to ensure that PPF compensation is not less than 50% of benefits, but states that the government has made the 2019 order to avoid some members remaining subject to the lower 2018 cap. It expects that few members will receive less than 50% compensation as a result of the cap.

Master trust update

TPR's latest figures on the master trust market show that, as at 31 January 2019, eight applications for authorisation have been received, while 44 schemes are expected to either apply for authorisation or trigger their exit from the market in the short term. Another 31 have already triggered their exit from the market. As the application deadline approaches, TPR has reminded schemes to ensure that they have allowed sufficient time to complete and submit an application.

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