FYI® Alert
For Your Information®

Volume 2020

Issue 13

1 April 2020

Authors
Gary Crockford
Nikki Williams

COVID-19 – Further Regulator Guidance

On 27 March 2020, the Pensions Regulator published further guidance for trustees, specifically covering DB scheme funding and investment.

This follows on from and expands the guidance the Regulator published on 20 March which was the subject of an earlier FYI Alert.

While making it clear that the guidance does not supersede trustees' fiduciary duties or obligations, under the law or under pension scheme rules, the Regulator has set out a number of temporary concessions to aid trustees faced with difficult choices in the current environment.

The Regulator, however, makes it clear that it expects "trustees to do the right thing for their situation and members".

Background

As the COVID-19 pandemic continues to sweep the globe, challenging times call for innovative measures, and the Regulator, in trying to be as pragmatic as it can, is publishing the sort of guidance which a few months ago we would have thought we would never see.

Its initial guidance, quite understandably, focused on paying DB pension benefits on time, minimising the risk of members being scammed, supporting members in making good decisions in a challenging environment and collecting employer contributions from distressed employers.

This second set of guidance expands on some of the earlier issues but in particular looks at:

- Schemes completing their valuations now;
- Employer requests to suspend or reduce deficit repair contributions (DRCs);
- Employer requests to suspend or reduce payments for future service in open DB schemes;

- Requests to release security;
- Cashflow; and
- Transfer values.

Scheme valuations

Whilst the pandemic has resulted in very different conditions today than those prevailing a year or so ago, the Regulator has indicated that in agreeing a valuation, those schemes who are nearer the completion of their valuations do not necessarily have to revisit their assumptions. However, they will be expected to allow for relevant experience since the date of the valuation in their recovery plan.

Where trustees consider they should revisit their assumptions in the best interest of their members, or where they need more time to consider the current situation or to see how it develops, the Regulator will allow a short delay of up to an extra three months before it considers imposing sanctions. The Regulator will consider this easement again in three months' time when it hopes the situation regarding COVID-19 will be clearer.

The Regulator has said that it will give further guidance in its Annual Funding Statement which is to be published after Easter for schemes with valuation dates between 22 September 2019 and 21 September 2020 (Tranche 15 Schemes).

Requests to suspend DRCs

The Regulator urges trustees to consider requests to suspend DRCs in the light of the employer's corporate health and to balance the needs of the pension scheme against the sustainable growth of the sponsoring employer.

In the short term where an employer makes a request for an immediate suspension of DRCs any suspension should be of short duration and no more than three months whilst trustees carry out appropriate analysis and take proper advice on the request. Employers are expected to provide trustees with the financial information they need to do this in a timely manner. The less confident the trustees are of getting this information in a timely manner the shorter any initial suspension of DRCs should be.

Dividends and any other form of shareholder return must be suspended along with any other forms of value leaving the employer in the terms of a legally binding commitment. Trustees should also be mindful of how other creditors are supporting the employer when agreeing any concessions to ensure equality of treatment.

Trustees of pension schemes where employers make annual contributions or where employers are due to make substantial contributions in the period of suspension are urged to take special care before agreeing any suspension.

Longer suspensions or reductions should be considered in the light of the Regulator's earlier guidance on corporate distress.

Where any suspension is in force trustees must continue to monitor the employer covenant as the pandemic unfolds and usually only offer short term concessions until the long-term covenant position becomes clear. An exception may be where other creditors offer the employer longer term support where it may be appropriate for the suspension to match a similar timeframe.

Trustees must take legal and actuarial advice both on whether or not to suspend DRCs and the appropriate form of doing this. One question to consider is whether the Schedule of Contributions (SoC) should be amended or payments suspended without an amendment of the SoC? It is important that the pension scheme rules are consulted as non-payment could, for example, trigger a wind up.

Although the Regulator has said it will not take enforcement action in certain circumstances the requirements to report breaches to the Regulator are not altered.

Requests to suspend or reduce future service payments

If an employer of an open DB scheme requests an immediate reduction or suspension of future service contributions for employers, and possibly members, the guidance suggests treating them in the same way as requests to reduce DRCs.

The guidance notes, however, that there are additional considerations and trustees would be urged to take legal advice before agreeing to any such suspension. It is unlikely, for legal and practical reasons, for this to be a realistic option for employers.

Requests to release security

Trustees may face requests to release security. However, if they did so and the employer fails to recover they will have lost access to a potentially valuable asset. It is very unlikely releasing security would be in the best interest of members. Again, faced with such a request, trustees should take legal and financial advice. Where security is to be released there is an expectation trustees will obtain some sort of alternative security or mitigation from the employer. Schemes should be treated equally with other creditors and any relaxation requests should not be limited to schemes.

Cashflow

Trustees are likely to find their funding levels have fallen as a result of the fall in investment markets and decreases in yields. While pension schemes are long term investments one short term risk for trustees is their cashflow.

The guidance recommends that trustees consider the following:

- Their expected cashflow in the short to medium term and how this might vary in the pandemic environment as a result of member movements (e.g. early retirements, transfers, and funded death payments).
- Their investment strategy and its continued appropriateness in relation to diversification, the need to rebalance, hedging etc.
- Their governance structures including integrated risk management and procedures in the event of incapacity of the trustees or their key advisers.

Transfer values

Trustees may want to review the terms they are offering for cash equivalent transfer values or in the light of increased demand for transfers. The guidance states that in such circumstances the trustees may suspend quoting CETVs and paying transfer values for up to three months. Whilst the Regulator cannot change disclosure time limits it will not take regulatory action against trustees who use this concession. Trustees should note reporting requirements are, however, not waived.

The Regulator cannot guarantee that where trustees breach statutory time limits the Pensions Ombudsman will not find against them in a subsequent complaint. It states, however, that the Ombudsman will take the Regulator’s guidance into account when assessing the reasonableness of the actions of trustees.

Trustees who, at the end of the three-month extension, still consider it is in the best interests of the members generally to continue to suspend CETVs or transfers should notify the Regulator in the usual way.

As with the initial guidance the Regulator urges trustees to be on the look out for pension scammers and unscrupulous financial advisers.

Comment

Trustees who are concluding their valuations, or have cashflow issues, or have employers in financial difficulty will welcome this further guidance from the Regulator.

These easements are currently only in place until 30 June 2020.

The Regulator, along with the rest of the world was not prepared for this pandemic and is trying to be pragmatic and reacting to events as they unfold.

Produced by the Knowledge Resource Centre
The Knowledge Resource Centre is responsible for national multi-practice compliance consulting, analysis and publications, government relations, research, surveys, training, and knowledge management. For more information, please contact your consultant or call us on 0800 066 5433.