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Current issues

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Levée en masse

The Department for Work and Pensions (DWP) proposes to substantially increase the general levy on pension schemes for the years from 2024/25 to 2026/27. Its favoured approach would result in schemes with fewer than 10,000 members paying an additional £10,000 'premium', in April 2026, on top of the usual per-member levy, to help recover the levy deficit whilst incentivizing consolidation.

Background

The general levy is collected annually by the Pensions Regulator on the DWP's behalf. It is intended to recoup the DWP's funding of the Regulator, the Pensions Ombudsman, and the pensions-related activities of the Money and Pensions Service.

The levy is reviewed occasionally, based on anticipated receipts, spending plans, and actual costs. The Government cut the levies in 2013 on that basis. In 2017, in a bid to eliminate a surplus that had by then accrued, there were additional reductions, but only for the very largest schemes; the levies were held steady for others.

By the time of the 2020 review, however, there was a growing deficit.[1] The Government responded by increasing the levy rates. Additionally, having previously made a distinction only between occupational and personal pension schemes, the decision was taken to restructure the levy to better reflect the risks represented by four different types of scheme: defined benefit (DB) and hybrid, defined contribution (DC) master trusts, other DC occupational schemes, and personal pensions. In the three years since that review (2021/22 to 2023/24), the levies for DB & hybrid schemes have roughly doubled, and those for DC occupational schemes other than master trusts have increased by around 37%, with lesser increases for the other, less-risky, scheme categories. The changes were meant to recover the deficit by 2030/31.

[1] Then estimated to reach £80m by 2021.

The best-laid plans

The DWP now estimates that, without further alterations, there will be a deficit of almost £205m by 2030/31. This is attributed to the expansion in the activities of the DWP-sponsored organizations. It presents three options. The first is to leave the levy rates and structure unchanged, and allow the deficit to burgeon, whereas the other options would, according to the DWP's projections, eliminate the deficit by 2030/31.

Option 2 would also retain the current structure with its four categories of scheme, but with across-the-board 6.5% increases to the levy rates in each year. The DWP says that the magnitude of these additional increases '*does not support the policy direction*' (presumably because the burden of the increases would not be distributed based upon the relative risks of the different categories of schemes).

Option 3 is, accordingly, the one that the DWP prefers. It would increase the levies by 4% per year, but charge schemes with memberships under 10,000 an extra £10,000 each. This additional 'premium' would not be introduced until April 2026, giving those smaller schemes two years in which to ponder whether consolidation would be better for their members. The DWP says that such consolidation would support its value-for-money initiative, and its desire to have schemes invest in a wider range of assets. A revenue forecast in an appendix to the consultation document assumes that half of '*all schemes in scope*' [for the premium?] consolidate by 2026.

Those who wish to pass comment on the DWP's proposals should do so by 13 November 2023. The consultation document asks, among other things, whether pension schemes would seek to pass increased costs on to members or sponsoring employers.

We can expect to see some 'robust' responses to the DWP's proposals. As behavioural 'nudges' go (c.f. auto-enrolment), those representing smaller schemes are especially likely to view the £10,000 premium—with its explicit aim of spurring consolidation—as something more akin to arm-twisting. It would be a very blunt instrument, payable irrespective of individual small schemes' standards of governance.

Note also that the DWP talks about *introducing* the £10,000 premium in the 2026/27 levy year: the implication is that it would not be a one-off charge. In the first year of its introduction, the premium is predicted to raise more than the rest of the Option 3 levies combined.

On the other hand, it would clearly be unacceptable for the DWP to permit the deterioration of the levy funding position to continue. There is no sense that 'Option 1' is genuinely on the table, so trustees and scheme managers must surely brace themselves for significant cost increases. This is particularly so given the Parthian shot in the consultation document indicating that the Government has accepted independent reviewer Mary Stark's recommendation that it make the pensions sector fully responsible for the Regulator's funding.

VAT a palaver

His Majesty's Revenue and Customs (HMRC) has published draft legislation intended to provide continuity in the operation of value-added tax (VAT), in the wake of the UK's exit from the European Union. The draft legislation, which is destined for inclusion in the next Finance Bill, should mean that VAT on pension scheme management expenditure continues to be recoverable as it is currently—provided, that is, that trustees and sponsoring employers can jump through the existing hoops.

Background

The Retained EU Law (Revocation and Reform) Act 2023 will (broadly) remove aspects of EU law from the law of the UK at the end of 2023 (some sections of the Act have not yet been brought into force). If nothing more is done, that could create uncertainty over the application of judicial rulings in VAT cases decided on EU legal principles. In the pensions sphere, that might have included the *PPG* and *APT* judgments about the VAT treatment of fund management expenses.[2]

Proposed changes

The draft legislation would broadly maintain EU-derived rights and legal principles in so far as they are relevant to the interpretation of VAT law. However, incompatibility with EU law will no longer result in disapplication of UK legislation, and the higher courts in the UK will be able to deviate from EU case law when appropriate in light of changed circumstances and if it would otherwise restrict '*the proper development of domestic law.*'

Consultation

Comments upon the draft legislation should be submitted by 17 November 2023.

For a brief period following the PPG judgment there was hope for a (relatively) straightforward route to recovery of VAT on investment-management services supplied to defined benefit schemes, but that proved not to be so—perhaps one should not have been surprised, given that HMRC is not in the business of cheerfully relinquishing tax revenues. The proposed legislation should mean that, for the foreseeable future, the VAT treatment of funded occupational pension schemes remains as set out, respectively, for DB and DC schemes, in HMRC's VAT Input Tax Manual (starting at VIT4460) and VAT Finance Manual (VATFIN5120).

Heads on spikes on London Bridge

The Pensions Regulator has announced the first fine for climate-reporting failure.

Requirements

Climate-governance obligations began to be imposed on trustees of private-sector occupational pension schemes on 1 October 2021. Initially, only schemes with net assets of £5bn or more were affected, but that threshold was lowered to £1bn a year later. Trustees of schemes that are subject to the requirements must produce a climate-change report within seven months of their scheme year-end outlining their approach to climate-related risks and opportunities. Most relevantly for the events underlying this article, the report must be made publicly and freely available on a website, by the same deadline.

Generally, the Regulator will issue a compliance notice when it believes that trustees are not meeting their climate-governance obligations, and can then impose penalties if those notices go unheeded. The penalty can be up to £5,000 when the transgressor is an individual (i.e. human), and up to £50,000 in other cases (e.g. for corporate trustees).

In the case of failure to publish a climate-change report online, however, a fine is *mandatory* (the Regulator has no discretion), the *minimum* is £2,500, and the penalty is not preceded by a compliance notice.

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[2] *Fiscale eenheid PPG Holdings BV cs te Hoogezand v Inspecteur van de Belastingdienst* [2013] EUECJ C-26/12; *ATP PensionService A/S v The Skatteministeriet* [2014] EUECJ C-464/12.

The mistake

More details of the case, the first of its kind, are given in a regulatory intervention report (RIR).

The climate-change report for the ExxonMobil Pension Plan was due to be published by 31 July 2022. The Regulator contacted the scheme's trustee, following the expiry of the deadline, when it was unable to find a report for the scheme online. It turned out that the trustee had prepared the report, and believed that it had been published, in time. However, an error with the web address used by the scheme administrator meant that it was inaccessible. The mistake was rectified soon after the Regulator's intervention: the report became publicly available on 10 August 2022.

The Regulator issued a penalty notice in respect of the mandatory fine, for £5,000. Its report says that it imposed an above-minimum charge, in line with its monetary penalties policy, '*because it was a corporate body and to reflect the nature of the breach.*'

The Regulator prides itself in taking a proportionate and risk-based approach to its interventions. No doubt it was also eager to make a show of resolve on a subject of such immediate relevance and importance. Those two desires can be in tension. Readers will have to make up their own minds about whether the Regulator might have lost sight of the former aim when seizing this opportunity to put a high-profile head on a spike—and may wonder whether the decision was influenced, consciously or otherwise, by the sponsoring fossil-fuel company's negative ESG associations.

The DWP in its wisdom made this non-compliance fine mandatory. The Regulator's only discretion was over the amount. On the one hand, it seems that 'the nature of the breach' in this case was technology-related and innocent. On the other, it would have been easy for the administrator to check that the URL worked as expected (the rest of us always do that, don't we?). The fine, though double the minimum, is only 10% of the maximum penalty for a corporate body—and doubtless (to the extent that such considerations are relevant) triflingly small change for the corporate parent.

That said, the decision to name-and-shame was entirely the Regulator's, and may seem rather unfair in the circumstances (we were going to say 'draconian', but Draco thought cabbage-pilfering ought to be punishable by death, and we don't want to be accused of hyperbole). Regardless, trustees of other schemes should be aware that the Regulator's policy is to publicize all mandatory climate-reporting fines in its compliance and enforcement bulletins—irrespective of the circumstances of the breach.

Spotlight on the 'S' in ESG

The Taskforce on Social Factors has announced the publication of a draft Guide, containing recommendations on how the pensions industry can incorporate such factors into investment decision-making.

The Taskforce was established by the Department for Work and Pensions in July 2022. Its assignment is to increase attention to the social aspects of responsible investment and carry out research into the availability of good data and dependable metrics.

The first part of the Guide is arranged into three sections covering—

- the importance of social considerations and how they fit with trustees' fiduciary duties;
- what data exist and how they can be assessed; and
- how social factors can be tackled (with special attention to 'modern slavery').

The Taskforce then makes thirty-five recommendations, addressed variously to trustees, regulators, government, asset managers, data providers and proxy voting agencies, investment consultants, legal advisers, non-governmental organizations, and businesses. They cover matters such as the flow of information, social-factor frameworks, disclosure and regulation, and improving practices.

Written responses to the Taskforce's proposals are invited by 1 December 2023. The Taskforce says that it will also organize a series of roundtable discussions.

The (Regulator's) view from the summit

Nausicaa Delfas, the Pensions Regulator's Chief Executive, gave a speech at a Pensions Summit at Mansion House in the City of London on 25 October 2023. She said that consolidation into larger, better-run pension schemes will facilitate asset diversity and help achieve optimal retirement outcomes.

In Delfas's view, what the Regulator expects of schemes are:

- sophisticated investment governance practices;
- diversified investments made with due care and attention;
- an efficiency mindset; and
- highly qualified trustees.

Although the Regulator will not tell schemes how to invest, or advocate one asset class over another, Delfas said that it will challenge decision-making to ensure that trustees are acting in members' interests. Having mentioned the opposing evils of excessive risk and inadequate returns, she said that '*The key is achieving the right balance through investing in a properly diversified portfolio.*' Developing the theme, she added that the Regulator is '*supportive of innovation which is in savers' interests and initiatives which call on trustees to consider well-thought-out diversified investment strategies.*' It will publish guidance on private-markets investment by the end of the year, and update its defined benefit (DB) and defined contribution (DC) investment guidance '*in due course*'.

According to Delfas, the new DB funding Code of Practice will say that there are no limitations to what constitute suitable investment assets. It will also say that all schemes can invest in growth assets, whilst recognizing that open schemes and those further from their final destination have more latitude. On the DC side, there will be standardized disclosure of data on key components of value, going beyond cost, via the proposed new VFM framework.

The Regulator will '*go beyond basic compliance and seek to influence the market and drive ever greater outcomes.*' Not only will schemes have to disclose more information, they will be expected also to '*analyse, interpret and act to spot and mitigate risks before they materialize.*'

Delfas concluded her speech as follows:

> '*To the schemes that do not have the scale, expertise, or appetite to meet our challenge and truly deliver for savers our message is clear. It is time to consolidate and move their savers into a scheme that can. Savers deserve nothing less.*'

Zen & the art of motorcycle miscreance

The Pensions Regulator has published a regulatory intervention report on its investigation and criminal prosecution of Stuart Garner, the former owner of Norton Motorcycles and sole trustee of three pension schemes.

Garner was found to have committed multiple employer-related-investment infractions, having used almost all of the schemes' assets (resulting from 255 members who had transferred in) to prop up his ailing business. For his endeavours he has garnered (pun absolutely intended) three suspended prison sentences, a three-year disqualification from acting as a company director, and a lifetime trusteeship ban.

In addition, the Pensions Ombudsman has directed Garner to repay approximately £15.7m, causing him to be declared bankrupt. The Fraud Compensation Fund (operated by the PPF) has intimated that the schemes are, in principle, eligible for compensation (there being reasonable grounds for believing that losses arose from dishonesty).

Not at this address: postal problems & penalty notices

The First-tier Tribunal recently set aside fines issued to an employer for non-compliance with its automatic enrolment duties.[3] The Tribunal said that penalties were inappropriate in the circumstances, because the employer likely had not received the Pensions Regulator's notice directing it to take steps to remedy the contravention, and that the Regulator had been wrong to refuse the employer's requests for review of the penalty notices.

Facts

The employer's pensions provider reported it to the Regulator, saying that it had failed to pay auto-enrolment contributions due between 29 March and 28 June 2022. The Regulator issued an unpaid contributions notice (UCN) on 30 August 2022. It used the postal address that the employer had supplied, which was the same as that of its registered office, but prefixed with the name of the shop that it ran there.

On 15 October 2022, having received no reply by the UCN's 10 October deadline, the Regulator issued a £400 fixed penalty notice. It subsequently, on 24 November, also issued an escalating penalty notice (EPN): it warned that, from 22 December, additional fines would accrue at the rate of £500 per day.

The employer contacted the Regulator on 29 December, saying that the new tenant of a residential flat at the same address had passed along the EPN on 27 December. The notice had been mistakenly delivered to the flat whilst it was unoccupied. The employer said that it had not received any of the earlier correspondence.

The employer twice asked the Regulator to review the penalty notices. The Regulator declined to do so because, it said, the requests had been made outside of the time limit for review applications (the Regulator also has power to review penalty notices if it '*considers it appropriate*').

On 10 January 2023, the pensions provider reported that the late-payment issue had been resolved.

Appeal

The employer appealed to the First-tier Tribunal (FTT). The Regulator argued that the FTT lacked jurisdiction because the statutory preconditions for the appeal were not met: either the Regulator must have completed a review, or the appellant must have made a valid application for review and had it rejected.

The Regulator also relied upon the statutory 'presumption of [postal] service'. That is to say: the law has, as a matter of policy, adopted the stance that a notice issued by the Regulator shall be taken to have been received by the addressee.

Ruling

The FTT judge cited an Upper Tribunal (UT) judgment which confirmed that the presumption of service is not irrebuttable. Moreover, the same UT judge had described as '*a statutory nonsense*' the suggestion that, when determining whether a person has beaten the deadline for challenging a notice, that person should be treated as having received notices that they did not actually receive.

The FTT judge wondered what evidence the employer could be expected to provide about the fate of the earlier notices, if it had never received them: it could not know with certainty what had happened to them, but had supplied a plausible explanation based on the delivery of the EPN to the unoccupied flat. That amounted to more than a bare assertion that the notices were not received: the fact that the EPN was discovered by the new tenant indicated that the others were also likely to have been mis-delivered.

The judge found that, on the balance of probabilities, the UCN and FPN had not been received, and that the EPN was not received until it was handed over by the flat's new tenant. That meant that the Regulator was wrong to say that the requests for review of the notices had been submitted late, and therefore wrong to refuse to carry out the reviews.

On balance, the judge concluded that the employer had a reasonable excuse for non-compliance with the UCN.

She noted some concern that the employer's registered office was so readily confused with the residential flat. However, she said that it had taken the reasonable step of including the shop's name in its correspondence address, which ought to

[3] *A & P Trading Solutions Limited v The Pensions Regulator* [2023] UKFTT 00772 (GRC).

have ensured correct delivery. Nevertheless, she warned that the courts would be less likely to accept the same excuse if there was any recurrence of the problem, now that it had been recognized.

The FTT judge directed the Regulator to set aside the penalty notices.

There are frequent appeals against auto-enrolment fines, and the aggrieved employers all-but-invariably claim that they didn't receive the Regulator's correspondence. In most cases, it is nothing more than an assertion, unsupported by evidence of postal problems. (In several that we have read the judge has remarked on how strange it was that all letters went astray other than the final one that imposed the fine—which had the employer reacting like a scalded cat.)

This appeal was unusual in that the presumption of service didn't carry the day. The (almost) unbroken chain of past successes may have led the Regular into over-confidence about the size of hurdle that the presumption represents for employers. There's also a hint of Catch-22 in its insistence that the employer had to challenge the penalty within 28 days of a notice that it seemingly hadn't received.

SIPP administrator duped by fraudster

The Pensions Ombudsman's determination in *Mr N (CAS-38681-W2H9)* tells the (thank goodness) unusual story of a scheme administrator that was conned by a swindler who somehow gained access to a member's email account.

Starting around page 10, the determination lists reasons why the administrator ought to have questioned the fraud's instructions to divert drawdown payments to a new bank account. For example, there were irregularities with the bank statement that was provided as evidence that the new account was genuine: the 'certified copy' wording was at lower resolution and appeared to the Ombudsman to have been copied and pasted on. There were also geographical anomalies, in that the Northumberland-resident member had ostensibly, and in short order, set up the new account at a London bank branch and then drafted in a Birmingham accountant to certify a bank statement as genuine, making it unlikely that the accountant had seen the physical statement.

The fraudulent drawdown-instalment instruction came hard on the heels of a legitimate one, and should therefore have raised suspicions. The reason given for the account-change was that the member's real account was not accepting deposits, which was somewhat at odds with the successful payment made less than a week previously. The criminal first tried to have the money sent to an international bank account, then suggested one belonging to a third party; it was only when the administrator refused those requests that the thief set up the London account.

Lastly (though we are less convinced that this is evidence of something out-of-the-ordinary) the impersonator's emails to the administrator were 'written in intelligible but obviously flawed English.'

The Ombudsman said that the combination of these factors ought to have raised suspicions, and should have led the administrator to take additional steps to verify that the instructions and supporting evidence were genuine. The administrator was directed to restore the member's pension fund to the level that it would have been at had the fraudulent transfer not been made.

Cyber crime being, deplorably, a growth industry, this is the sort of thing for which trustees and scheme managers must increasingly be on guard.

Public sector update

2022/23 LGPS statistics

The Department for Levelling Up, Housing and Communities (DLUHC) has published 2022/23 statistics for the Local Government Pension Scheme (LGPS) funds in England and Wales. The introduction contains notes about missing data and use of provision information because of the delays to local authority audits, so revisions are expected.

According to the release, the total expenditure in England and Wales in 2022/23 was £15.2 billion and the total LGPS income was £17.3 billion. The market value of LGPS funds as at end March 2023 was £357.2 billion and there were 87,129 retirements from the LGPS in 2022/23.

Guidance on correction of pension contributions

His Majesty's Revenue and Customs (HMRC) has published guidance on Correction of Pension Contributions Following the Public Services Pensions Remedy. As it notes, however, *'Chapter 3 schemes [the LGPS] do not have any changes to their contributions*.'

Guidance on common actuarial approaches

The LGPS Advisory Board for England and Wales has published guidance on common actuarial approaches upon conversion of a school to an academy. It provides information on the common nomenclature for conversion methodologies; factors influencing what conversion decision a fund will adopt and the possible consequences of the choice of methodology over time.

'McCloud' newsletter

HMRC also published an October 2023 edition of its Newsletter on the Public Service Pensions Remedy. For a summary, see our article *HMRC Newsletters: October 2023*, below.

HMRC newsletters October 2023

His Majesty's Revenue and Customs (HMRC) has published *Pension Schemes Newsletter 153*. It contains updated defined-contribution flexibility and scheme-registration statistics, along with the now-customary update on the development of the online Managing Pension Schemes service. On the last point, more schemes are likely to be asked to submit pension scheme returns, via MPS, than in the past, and to supply more information, because they are going to be used to police pensions tax compliance.

HMRC has also published an October 2023 *Newsletter on the Public Service Pensions Remedy*. It mentions the potential need to review or revise member communications as a consequence of the remedy for *McCloud* discrimination; the launch of an online service allowing members to correct their annual and lifetime allowance records and (where applicable) get compensation for overpaid charges; and guidance for members and administrators.

And Finally…

The Pensions Regulator received just seven whistleblowing disclosures in the year to 31 March 2023, mostly about suspected legislative breaches. It seems that the low number may be partly explained by a change of policy on how it defines 'whistleblower'—presumably to exclude reports from conspiracy theorists and those suffering from delusions.

AF was once accused of active participation, or at least Watergate-style complicity, in the burgling of a scheme member's house. Because, otherwise, how could we have obtained the information for the pensions-on-divorce valuation that we'd prepared? Eh? Well? How?!

This vociferous denouncement was the cause of some mild alarm for your correspondent, who was then but a callow youth, fresh out of university, and no doubt adorned with a comically ill-fitting suit and the sort of late-'90s tie that could envelop a double duvet and cause lasting retinal damage. On scurrying to the filing cabinets (back then there was this thing we called 'paper'…), his consternation was allayed somewhat. It turned out that the member and his wife—or at least their respective solicitors—had jointly commissioned the report. The gentleman was, as one might imagine, thrilled to learn that, not only was he the ultimate source of the (legitimately obtained) information used for the valuation, he was paying half our fee.

That was also the occasion on which *AF* learned, when colleague called the member's solicitor as a professional courtesy to give him a heads up about the incoming barrage, that *in extremis* one can remotely *hear* an eye roll…