SQUIRE PATTON BOGGS

#PensionsTensions

Exploring the Long-term Stresses and Strains on UK Pension Saving Following the COVID-19 Pandemic

#How2DoPensions

Part 3: The Employer Experience

#PensionsTensions Overview

The global coronavirus pandemic has had a seismic impact on our economy and lifestyles. Whilst some of the challenges posed by COVID-19 are expected to be short-lived, the longer-term implications of the crisis remain unclear. The slower pace of life during lockdown has given many people an opportunity for reflection, and it is likely there will be some permanent changes to how individuals live, work and save for retirement, as well as new and ongoing challenges and opportunities facing pension scheme sponsoring employers and trustees. In this series of publications we examine the key areas of pension tension, in each case exploring four aspects, assigning them a #PressureMeasure (the higher the score the greater the pressure being faced) and giving our view on where further reflection might lead to welcome change.

Relationships – How Can Employers Balance their Corporate Objectives with Maintaining a Good Relationship with their Pension Scheme Trustees?

A breakdown in the trustee-employer relationship can have damaging consequences for scheme governance and member outcomes, and trust can take time to rebuild. During scheme funding negotiations, most trustee boards will have felt tensions arising from the different expectations of The Pensions Regulator (TPR) and the sponsoring employer. Extra challenges can arise where the sponsoring employer is owned by an overseas parent company that is unfamiliar with the rigorous regulatory framework applicable to UK defined benefit (DB) schemes.

Disagreements commonly arise where employers are reluctant to supply confidential financial data to trustees.

The need for transparency can often be balanced with commercial sensitivity by putting in place information-sharing protocols, confidentiality undertakings and robust trustee conflicts of interest policies. These documents are sometimes only considered when there is already a strained relationship, or when a specific need arises, such as a potential corporate takeover. However, there may be merit in agreeing ongoing information-sharing arrangements, to reinforce a culture of openness and trust, so that expectations can be managed and to enable prompt sharing of information in time-critical situations.

Affordability – Has the Pandemic Made DB Schemes Unaffordable?

With many businesses (and some entire industries) fighting for their survival, the long-term funding needs of a pension scheme are placed in stark contrast with the immense immediate financial strain caused by the pandemic and ensuing lockdown. However, the long-term nature of DB pension schemes means that the outlook may be positive, if sponsoring employers with an otherwise stable covenant can weather the (hopefully relatively short-term) impact of the pandemic.

Employers have a number of possible financial easements available to them, including deferring pension contributions if the trustees agree, as well as separate negotiations with landlords, banks and other creditors, and of course the furlough scheme. Changes to UK insolvency law (some temporary and some permanent), which we explored in our recent series of blogs, may also assist in some circumstances. Last-minute changes to these reforms have mitigated some of the unintended negative consequences for schemes whose employers do not survive.

For other employers, favourable pricing in the buy-out market means that the pandemic may have brought them closer to meeting their long-term goal of securing their DB liabilities with an insurer, if they are poised to transact quickly (we discussed the data issues of getting "buy-out ready" in part 2 of our #PensionsTensions series).

In June 2020, TPR published interim guidance on DB consolidator schemes (also known as "superfunds"). It is unclear to what extent this move was prompted or accelerated by the pandemic, but the guidance may have piqued the interest of employers looking for alternatives to buy-out. The interim guidance paves the way for new commercial models to emerge but there is still a long way to go before superfunds become mainstream and it is not yet clear when draft legislation will be published. This will be a key area to watch.

We are in challenging times, but there is room for optimism in the longer term, provided sponsoring employers can withstand the pressure.

Regulatory – What Challenges are Posed by New Regulatory Powers?

#PressureMeasure: 6/10

The Pensions Bill 2019-2021, when enacted, will extend the existing framework of events that must be notified to TPR to: include additional types of corporate activity; require trustees to adopt a long-term funding and investment strategy; and introduce more severe criminal penalties and fines for misconduct.

These measures are designed to protect members, but will increase compliance costs for employers. They will also potentially increase risk for employers; for example if the prospect of regulatory involvement dampens legitimate commercial activity.

TPR's new Funding Code of Practice, when finalised, is expected to further encourage trustees to focus on the long-term security of members' benefits. Many schemes already have longer term and secondary funding targets; the ultimate goal may be buy-out with an insurer. Journey plans will need to be robust but also flexible enough to withstand financial pressures for the employer and to enable prompt review and modifications to mitigate the risk of being blown too far off course.

The outcome of all of these challenges may be a further impetus towards de-risking activities.

Adaptability – Is Current Scheme Design Fit for Purpose for a Post-COVID Workforce?

#PressureMeasure: 4/10

In part 1 of our #PensionsTensions series, we considered changing attitudes to working habits as a result of COVID-19. This raises the question of whether increasingly flexible working will increase pressure on government and employers to provide more flexible pension schemes.

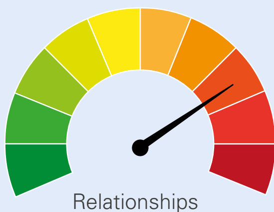
The current UK pensions tax regime has strict limits on how much can be saved tax efficiently during employment and after benefits come into payment. Early access to pension savings in a time of financial hardship comes with severe tax penalties. The UK system has been designed to align the encouragement of long-term savings through generous tax reliefs with ensuring savings are used as intended to fund retirement.

However, changing work and income patterns call for a re-examination of some of these detailed rules, to ensure pensions remain both fit for purpose and an attractive vehicle for long-term savings. For example, could the tax rules be better adapted to facilitate partial retirements? Likewise, would there be benefits in increasing the permitted time period between a member accessing his pension commencement lump sum and his monthly pension coming into payment?

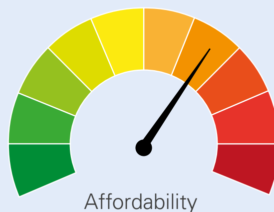
Reflecting on these #PensionsTensions

Employers operating legacy DB arrangements will be familiar with the time and cost of managing those liabilities. The pandemic may have exacerbated those pressures in the short term and scheme journey plans will need to be adjusted accordingly.

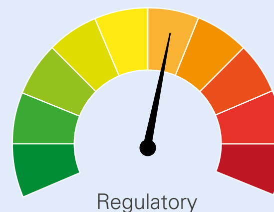
When assessing whether pensions are fit for purpose, the elephant in the room is, perhaps, the gap between DB and money purchase (DC) schemes. In Part 1 of the #PensionsTensions series, we identified adequacy and member engagement as areas of tension in relation to the member experience. At present, an employer's pension offering may be a secondary criterion for a candidate seeking a new role. In future, could higher levels of engagement with pensions mean a generous DC scheme becomes a differentiating factor for employers looking to attract quality candidates?.



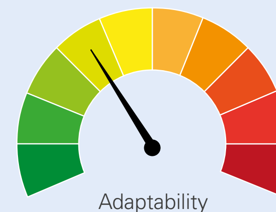
Relationships



Affordability



Regulatory



Adaptability

#PressureMeasure: the higher the reading on the gauge the more pressing the need for action/reform

Contact

Kirsty Bartlett
Partner, London
T +44 207 655 0298
E kirsty.bartlett@squirepb.com

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