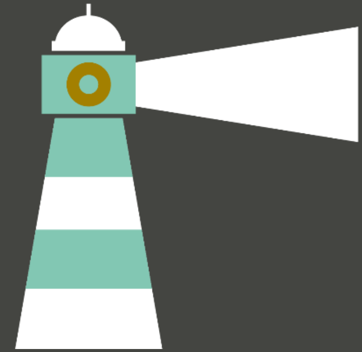
BRIEFING



What's Happening in Pensions

Issue 87 – March 2021

In this issue:

Pension Schemes Act 2021: The Pension Schemes Bill has received Royal Assent and thereby become an Act but only regulation-making powers are so far in force. Further developments are awaited, including as regards DB scheme funding and Pensions Regulator powers.

Climate risks and opportunities: The Government is consulting on draft regulations and statutory guidance to be issued under the climate change governance and disclosure provisions of the Pension Schemes Act 2021. The Pensions Climate Risk Industry Group (PCRIG) sponsored by the Government has also published its final non-statutory guidance.

Pension protection levy 2021/22: The PPF has published its final determination, appendices and guidance for the 2021/22 pension protection levy. It has also consulted on draft guidance for commercial consolidator schemes.

GMP equalisation working group: The PASA-chaired industry group on GMP equalisation has published initial tax guidance and an update on its current work.

Normal minimum pension age: The Government is consulting on proposals to raise normal minimum pension age from 55 to 57 on 6 April 2028, with some protections.

Investment consultants / fiduciary management: A delay to DWP regulations means that trustees will have to certify compliance with the investment consultancy and fiduciary management governance requirements to the Competition and Markets Authority again next January.

Automatic enrolment – 2021/22 figures: Automatic enrolment pension contribution costs will generally rise, following the announcement of the earnings trigger and qualifying earnings band figures for 2021/22.

Uber case on worker status: The Supreme Court's decision on employment rights for Uber drivers, whom it found to be workers, may have implications as regards pensions automatic enrolment.

Scheme returns: DB and hybrid scheme return information requirements are unchanged from last year.

PPF restructuring documentation and new guidance: The PPF has published certain standard documentation that it expects to be used when it is involved in a corporate restructuring. It has also published new interim guidance concerning the use of moratoriums and restructuring plans under the Corporate Insolvency and Governance Act 2020.

PPF compensation: In May, the Court of Appeal will hear the PPF's application for permission to appeal the Hughes decision concerning the compatibility of PPF compensation limits with EU law.

PPF valuation assumptions: The PPF is consulting on revised valuation assumptions for various purposes.

Cross-border schemes: The Pensions Regulator has updated some of its guidance on cross-border occupational pension schemes, following the end of the Brexit transition period.

Pension Schemes Act 2021

The Pension Schemes Bill received Royal Assent on 11 February 2021 and is now the Pension Schemes Act 2021.

The content includes provisions on:

- DB scheme funding and investment strategy;
- new grounds and non-compliance penalties for contribution notices;
- new criminal offences and financial penalties for putting benefits at risk and avoidance of employer debt;
- new notifiable events, accompanying statements and bigger penalties;
- climate change-related governance and disclosures;
- transfer scam protections;
- pensions dashboards;
- collective money purchase benefits; and
- PPF compensation for individuals with fixed pension transfer credits.

None of the substantive provisions took effect on Royal Assent: commencement orders are needed. Regulations are also required before many of the provisions can be brought into force, and to set out more detail around many of the substantive requirements.

In our briefing note, we look at each of the above aspects in turn and indicate what is known about what will now happen and when.

Climate risks and opportunities

Consultations on regulations and statutory guidance

The Government has published a response to is policy consultation on proposals for climate change-related governance and disclosure requirements under the Pension Schemes Act 2021. These requirements will be based on Taskforce for Climate-related Financial Disclosure (TCFD) principles but will be mandatory rather than voluntary.

As expected, the current consultation response includes a new consultation on two sets of draft regulations and draft statutory guidance to which trustees will be required to have regard. This consultation closes on 10 March 2021. (See WHiP Issue 84 for details of the original consultation and here for our response to that.)

Trustees will have to comply with requirements on governance, strategy, risk management, scenario analysis, metrics and targets relating to the assessment of climate risks and opportunities. They will also be required to make public disclosures about the steps they have taken in these areas. The requirements are being phased in, starting for some schemes from 1 October 2021.

When will schemes be affected?

Schemes with net relevant assets of £5 billion or more and all authorised master trusts and (if any) collective money purchase schemes will become subject to the substantive governance requirements from 1 October 2021. Schemes with net relevant assets of £1 billion or more are in scope from 1 October 2022. Schemes which reach £1 billion or more in a later scheme year will generally come into scope in their next following scheme year.

The public disclosure requirements apply from seven months after the end of any scheme year in which the scheme becomes or remains subject to the substantive governance requirements.

Asset values are measured at the end of the first scheme year to end on or after 1 March (i.e. on or after 1 March 2020 for the October 2021 £5 billion test). Once a scheme has met a particular threshold test, it broadly continues to be bound by the requirements until after it has less than £500 million in assets at a scheme year end (for authorised master trusts and collective money purchase schemes, additional conditions must be met before the duties fall away).

In a potentially significant change since the policy consultation, the Government is now proposing that bulk buy-in and individual annuity contracts will not count towards relevant asset values for these purposes (although the criteria here will need to be checked carefully).

A review, now scheduled for the second half of 2023 with a consultation in 2024, will look into extending the requirements to all schemes in late 2024 or early 2025.

Substantive governance duties

The draft regulations would impose the following new (highly summarised) requirements:

- Governance:

  Trustees must establish and maintain oversight of the climate-related risks and opportunities which are relevant to their scheme.

  They must also have processes to satisfy themselves that anyone else undertaking governance activities for the scheme takes adequate steps to identify, assess and manage relevant climate-related risks and opportunities. This also applies in respect of anyone (other than a legal adviser) who advises on or assists the trustees with governance activities.

- Strategy

  Trustees must, on an ongoing basis, identify climate-related risks and opportunities which they consider will have an effect over the short term, medium term and long term (such periods to be determined by the trustees) on the scheme's investment strategy and (for DB and hybrid schemes) funding strategy, and their impact on those strategies.

- Scenario analysis

  Trustees must, "as far as they are able", undertake scenario analysis which considers certain matters in in at least two scenarios where there is an increase in the global average temperature. In one such scenario the increase must be within the range of 1.5 to 2 degrees Celsius above pre-industrial levels (i.e. the temperature rise envisaged under the 2015 Paris Climate Change Accords). Scenario analysis must be carried out in the first year in which the governance duties apply to the scheme and then every three years (not every year, as previously proposed, but there must be an annual review of whether new scenario analysis is required). The matters to be considered in such scenarios are:

  - the potential impact on the scheme's assets and liabilities of the effects of the global average increase in temperature and of any steps which might be taken (by governments or otherwise) because of the increase in temperature;
  - the resilience of the scheme's investment strategy; and
  - where applicable, the resilience of the funding strategy.

- Risk management

  Trustees must establish and maintain processes for the purpose of enabling them to identify, assess and manage effectively climate-related risks which are relevant to the scheme. They must also ensure that management of climate-related risks is integrated into their overall risk management.

- Metrics and targets

  Trustees must select (and regularly review their choices) a minimum of:

  - one metric which gives the total greenhouse gas emissions of the scheme's assets ("absolute emissions metric");
  - one metric which gives the total carbon dioxide emissions per unit of currency invested by the scheme ("emissions intensity metric"); and
  - one other metric relating to climate change which does not meet either of the above descriptions ("additional climate change metric"),

  to calculate in relation to the scheme's assets (i.e. three metrics, rather than the two previously proposed).

  Trustees must annually and "as far as they are able" obtain three "scope" greenhouse gas emission measurements for the scheme's assets and then calculate their metrics and use those metrics to identify and assess the climate-related

risks and opportunities which are relevant to the scheme. These scope measurements relate to direct emissions, indirect emissions from electricity used, and other indirect emissions.

Trustees must set a target for the scheme in relation to at least one of their selected metrics and then annually measure, "as far as they are able", the performance of the scheme against that target. Taking into account the scheme's performance, they should then determine whether the target should be retained or replaced.

(These annual obligations were both originally proposed as quarterly ones.)

In relation to the scenario analysis, metrics and targets requirements, "as far as they are able" means that trustees will be required to take all such steps as are reasonable and proportionate in the particular circumstances taking into account the costs, or likely costs, which will be incurred by the scheme and the time required to be spent in doing so. There is a discussion of this in part 2 of the draft statutory guidance.

Disclosure: TCFD Reports

Trustees are required to publish what the draft guidance calls a "TCFD Report" on a publicly accessible website. This will need to set out in writing trustee decisions and findings in relation to the new governance etc. requirements set out above: items of required content are set out in the draft regulations. In addition, part 4 of the draft statutory guidance sets out things that trustees "should" (see below) do with regard to their disclosure obligations.

The report must be signed by the chair of trustees but the draft regulations expressly state that the signature need not be published.

Scheme annual reports, DB and DC benefit statements and (for DB and hybrid schemes) annual scheme funding statements will also be required to include information about the report.

Statutory guidance

The draft statutory guidance, to which trustees will have a statutory obligation to have regard, describes the obligations to be imposed by the regulations and things that the Government thinks trustees and others affected should do.

Where the word "should" is used, it says: "It is expected that trustees will follow the approach set out in the Guidance and if they choose to deviate from that approach they should describe concisely the reasons for doing so in the relevant section of their TCFD Report."

See below regarding the now finalised non-statutory PCRIG guidance.

Penalties

There is a mandatory penalty of at least £2,500 for failure to publish a report on a publicly accessible website. Penalties for other breaches are at the Pensions Regulator's discretion and are up to £5,000 for an individual and £50,000 for a company. There is also provision for compliance notices and third party compliance notices.

Registrable information

The information that schemes are required to provide to the Pensions Regulator is extended to cover the address(es) of the website(s) where the following are published:

- the TCFD report (or if not yet published, whether the period for required publication has ended);
- the scheme statement of investment principles and (where applicable) implementation statement and DC chair's statement extracts.

Trustee knowledge and understanding

In a new development since the policy consultation, the trustee knowledge and understanding requirements are also to be expanded to cover matters arising from the new requirements (but trustees will only be required to have this knowledge and understanding where the new requirements apply to their scheme).

Non-statutory guidance

The Pensions Climate Risk Industry Group (PCRIG), supported by the Government, has separately published final non-statutory guidance on aligning with TCFD principles.

Pensions Regulator blog post

David Fairs of the Pensions Regulator has written a blog post on the Pension Schemes Act. On climate change, he says:

"We will be launching our own climate strategy later in spring, which will explore these important issues in more depth. Our strategy will take a targeted, forward-looking approach and suggests that a landscape of resilient schemes that protect savings from climate risk is within reach.

This strategy will be comprehensive in setting out how TPR can help trustees meet those challenges – as well as how we can play our part in the low-carbon transition agenda."

Wider context

The UK occupational pensions sector is the first area of the economy where mandatory TCFD-based legal duties are being introduced. In November 2020, the Government's joint regulatory taskforce published a "roadmap" setting out indicative plans to introduce mandatory TCFD duties across the UK economy, including in the wider investment and asset management industries, over a phasing-in period.

Pension protection levy 2021/22

The Pension Protection Fund has published its determination and accompanying documents for the 2021/22 levy year.

These include the contingent asset appendix and guidance. Certification and recertification of contingent assets, including (for guarantees) submission of any guarantor strength report, is required by 31 March 2021 in order to qualify for a 2021/22 levy reduction.

The policy statement summarises the key changes this year. Points to note are as follows:

- The PPF's standard form contingent asset agreements now allow (but do not require) the inclusion of an exclusive English (or Scottish or Northern Irish) jurisdiction clause. This is intended to help with enforcement in court against an EU-based guarantor, under provisions of the Hague Convention on enforcement of foreign judgments, following the end of the Brexit transition period.
- Trustees and those preparing guarantor strength reports now need to consider the possibility of certain other creditors of a guarantor potentially gaining "super-priority" ahead of the scheme following a moratorium under the Corporate Insolvency and Governance Act 2020 (see WHiP Issue 83).
- For relevant types of contingent asset (not including guarantees), it is no longer acceptable for the counterparty (e.g. a bank issuing a letter of credit) to be regulated by an EU member state regulator.
- Due to the COVID-19 pandemic, contingent asset supporting documentation is to be submitted to the PPF by email, not in hard copy (the deadline for this is 5pm on 1 April 2021).
- There are some changes to insolvency risk calculations as a result of Dun & Bradstreet having replaced Experian as the provider to the PPF of insolvency risk scores.
- The individual scheme levy cap has been lowered and there is a "small scheme adjustment" to risk based levies.
- There is new draft guidance for commercial consolidator schemes: the final version is expected very soon.

GMP equalisation working group

Tax guidance

The PASA-chaired industry working group on GMP equalisation has published detailed good practice tax guidance. This was produced by a sub-group that included actuarial, scheme administrative and legal members and is chaired by our Head of Pensions, Daniel Gerring.

The guidance builds on two HMRC GMP equalisation newsletters (see WHiP Issues 80 and 83). Like those, it does not cover GMP conversion in any detail, nor equalisation in respect of transferred benefits (but see below). The group intends to say more on lump sums, which were the subject of the second HMRC newsletter, in the next version of this guidance.

An appendix sets out how GMP equalisation adjustments interact with fixed protection, enhanced protection, primary protection and individual protections during periods of deferment.

There are two template member communications included: one explaining to members their benefit crystallisation event recalculations, the implications and (where appropriate) the need for the member to communicate information to their other schemes; and the other for a member to send to HMRC where they wish to request the spreading of arrears payments over past tax years for income tax purposes.

Update on workflows

The group has also published a short update on its work and expected future guidance publication dates. Points of most interest are as follows:

- There is a new sub-group that has been looking at GMP conversion since November 2020. It is aiming to publish a document including case studies by the end of April 2021.
- Work has started on good practice guidance on equalising past transfer values. There will be an update on timescales in the first quarter of 2021.
- A further sub-group is preparing methodology examples addressing anti-franking – it is aiming to publish these in the second quarter of 2021.

Normal minimum pension age

The Government is consulting on implementation of the previously announced increase of normal minimum pension age under the Finance Act 2004 from 55 to 57 on 6 April 2028, with some protections. This is the lowest age at which benefits can generally be taken without incurring an unauthorised payments tax charge.

The increase will be a step change rather than a phased one: those born after 5 April 1971 are affected. Protections are proposed for members with rights under scheme rules as at 11 February 2021 (the publication date of the consultation) to take benefits earlier than age 57. All of any such member's benefits in that scheme, including future accruals, will be protected. 'Rights' do not include rights subject to consent and it is unusual for DB scheme members to have an absolute right to draw benefits in their fifties, so DC scheme members are likely to be the most affected.

Existing protected pension age rules, from when the normal minimum pension age of 50 was introduced in April 2006 and when it was raised from 50 to 55 in April 2010, will continue to apply. There are some differences from those earlier protected pension age regimes in the now proposed age 55 protected pension age: there will be more flexibility as regards drawing benefits while still working and drawing benefits in tranches, i.e. whereby protection will not be lost.

Members and schemes already need to be careful about this future protection being lost as a result of transfers that are not "block transfers". For example, consider a member currently aged 46 with a right under scheme rules to draw DB or (more likely) DC benefits at age 55. If they transfer individually today to a scheme where the rules provide that consent is required in order to do that, they will be subject to an unauthorised payments tax charge if the benefits are taken at age 55 on or after 6 April 2028. Even more starkly, such a member may have already transferred to such a scheme, well before 11 February 2021, and the consequences could be the same.

The consultation says that schemes should be able to impose the change sooner but there is no discussion of legal obstacles or the circumstances in which employers and trustees might wish to do that.

The increase will not apply to members of the armed forces, police and firefighters pension schemes.

The consultation closes on 22 April 2021. Draft legislation is expected in the summer and the legislation will be in the subsequent Finance Bill.

Investment consultants / fiduciary management

The Government has announced that the regulations to transfer to the Pensions Regulator responsibility for oversight of the requirements concerning investment consultants and fiduciary management providers have been further delayed, to the first half of 2022. That means that they will not be ready before January 2022, so there will be another early January deadline where trustees will need to certify their compliance to the Competition and Markets Authority.

Automatic enrolment – 2021/22 figures

The Government has reviewed the levels of the automatic enrolment earnings trigger and qualifying earnings band lower and upper limits for 2021/22. The outcome is as follows:

- The earnings trigger will remain at £10,000 pa.
- The qualifying earnings band lower and upper limits will be kept aligned with the lower and upper earnings limits for National Insurance Contributions. The band will therefore be £6,240 pa (the same as for 2020/21) to £50,270 pa (currently £50,000 pa).

Both of these decisions will result in higher employer pension costs, as earnings inflation brings more workers into scope and the earnings band widens.

Nothing has been said about the previously proposed mid-2020s automatic enrolment reforms, which included a proposal to remove the lower limit of the qualifying earnings band (see WHiP Issue 68).

Uber case on worker status

The Supreme Court's decision on employment legislation rights for Uber drivers, whom it found to be workers for the purposes at issue, may have implications as regards pensions automatic enrolment.

The Supreme Court's decision is specific to the facts of the case and did not consider automatic enrolment. The Court's analysis may, however, cause some other organisations to reconsider the status of those they have treated as contractors. The automatic enrolment legislation uses the term 'jobholder', rather than 'worker', but the definitions are strikingly similar.

Scheme returns

The Pensions Regulator has updated its web page on DB and mixed benefit (hybrid) scheme returns to say that the information requirements will be unchanged from last year. The Regulator had previously said that schemes might this year have answer questions relating to the web address of their published statement of investment principles and their assessment of employer covenant grade. Scheme returns are to be completed by 31 March.

PPF restructuring documentation and new guidance

The Pension Protection Fund has published standard documents, including a shareholders' agreement, articles of association and loan note documentation, that it expects to be used when it is asked to take part in a restructuring. These accompany existing guidance on the PPF's approach in these circumstances.

A common example of the PPF taking part in a restructuring is where it is asked to confirm (as required by legislation) that it has no objection to a regulated apportionment arrangement. These are arrangements under which liability for an employer debt is assigned, usually to a newly created shell company that is then immediately considered insolvent, in order to free the employer from its DB pension scheme liabilities and facilitate its rescue. Such arrangements usually involve the scheme entering PPF assessment in a controlled way. As well as the PPF being required not to object, regulated apportionment arrangements also require approval by the Pensions Regulator.

Separately, the PPF has published new interim guidance concerning the use of moratoriums and restructuring plans under the Corporate Insolvency and Governance Act 2020. Neither of these is an insolvency event for the purposes of the employer debt regime or the PPF entry rules but the PPF has certain rights to be given information (by the moratorium monitor or the company proposing the restructuring plan) and to be involved: see WHiP Issue 83 for more detail.

PPF compensation

The Pension Protection Fund has announced that the Court of Appeal will hear its permission to appeal application in the *Hughes* case concerning the compatibility of PPF compensation limits with EU law (see WHiP Issue 84) in the week beginning 4 May 2021. If permission is granted, the hearing will immediately become the appeal hearing.

The PPF is seeking to appeal regarding:

- the approach it can adopt to meet the requirement, following the *Hampshire* judgment (see WHiP Issue 72), for members to receive compensation of at least 50% of the value of their entitlement; and
- how to deal with survivors' benefits.

For its part, the Government is seeking to appeal the ruling that the PPF compensation cap is unlawfully age discriminatory.

PPF valuation assumptions

The Pension Protection Fund is consulting on proposed changes to the assumptions used for valuations under sections 143 and 179 of the Pensions Act 2004 (for the purposes of PPF assessment and the pension protection levy) and certain other purposes.

Proposed changes to (among other things) mortality assumptions and certain discount rates would, says the PPF, "improve the aggregate funding ratio from 93.5 per cent to 97.6 per cent, and move 261 schemes from deficit to surplus".

The consultation closes on 18 March 2021 and the changes would be implemented on or after 1 May 2021.

Cross-border schemes

The Pensions Regulator updated some of its guidance on cross-border occupational pension schemes on 9 February 2021, following the end of the Brexit transition period.

Trustees of UK cross-border schemes are told that UK law allows them to continue accepting contributions from an overseas employer but they also need to check the rules in the relevant country. Overseas employers who contribute to a UK scheme are given corresponding information. Trusteeship, tax registration and automatic enrolment requirements are also covered.

Where the cross-border scheme is based in the EU or EEA, local advice in the relevant country will be needed in addition to advice on domestic law.

Though it has not announced the revision of the guidance, the Regulator says:

> *"If you think you are either a UK-based cross-border pension scheme or you are a UK-based employer contributing to a non-UK scheme, but you have not received an email or letter from us or your host or home regulator about what you should do differently from 1 January 2021, please get in touch at brexitxb@tpr.gov.uk."*

The Regulator's main cross-border schemes guidance, now out of date, is still on its website.

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