KPMG

Pensions accounting, assurance and regulatory round-up

Private sector occupational pension schemes

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Introduction

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Welcome to the most recent edition of our Pensions accounting, assurance and regulatory round -up for private sector occupational pension schemes. This update covers a range of topics and considers developments from the Regulator, the DWP and the wider pensions industry.

If you have any queries or would like to discuss any of the matters herein further, please do get in touch with your usual contact at KPMG, Anne or Sarah, or email us.

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TPR: Guidance on protecting schemes from sponsoring employer distress

In November, The Pensions Regulator ("TPR") issued guidance for DB scheme trustees on how to recognize, and protect schemes against, sponsoring employer distress.

The guidance reminds trustees of their position and what is expected of them. Mike Birch, TPR's Director of Supervision, stated that:

"Trustees are the first line of defence for savers. The faster they act, the more options and greater time they'll have to protect members' retirements. Trustees should know the signs of distress, and preparations can be made before these signs appear."

The recent document builds upon themes we have seen in other TPR guidance such as early engagement, information gathering and encouraging open dialogue with the employer. The guidance provides a useful reminder that the options available to scheme trustees to protect members' savings reduce as the employer progresses towards an insolvency situation. A risk-based approach is encouraged with the aim of early identification and quick response. Trustees are encouraged to engage with the employer early and to seek advice; only getting the Regulator involved if a material risk remains.

TPR highlight key points arising as:

- all trustees should adopt a fully documented integrated risk management ("IRM") approach to their scheme, with workable contingency plans and suitable triggers in place.
- practising IRM will highlight problems early on, and the sooner trustees act, the greater the prospects of protecting the scheme's position. Trustees should regularly review these risk management and governance procedures to make sure they are fit for purpose.
- engaging regularly with the sponsor and with other creditors (where applicable) will help trustees to identify and manage key risks early on.
- if trustees delay putting robust scheme protections in place, other stakeholders, such as lenders, will be in a better position to exert control over and extract value from a distressed sponsor, potentially to the detriment of the scheme.
- trustees should remain alert to pensions scams or unusual transfer activity and prepare a communications strategy to support members when they are facing uncertainty.
- if a sponsor is facing the prospect of insolvency, trustees should refer to the Pension Protection Fund ("PPF")'s contingency planning guidance.

Trustees need to understand the legal obligations to the scheme to help assess risks and possible options available and ensure effective risk management is in place (including contingency plans).

Trustees should review scheme governance, ensuring that the trustee board contains the right skills mix and remedying any identified gaps in knowledge, ensuring conflicts on the board are managed, maintaining clear documentation and agreeing an information sharing protocol with the employer. Ongoing covenant monitoring is also highlighted and trustees are encouraged to review and challenge forecasts including stress testing of assumptions. The guidance highlights the importance of seeking advice noting that the scheme will not be the only creditor looking for value from the employer in a challenging environment.

Potential warning signs of corporate distress are noted including cash flow constraints and credit downgrades recognising that early engagement can improve the

TPR: Guidance on protecting schemes from sponsoring employer distress (cont.)

scheme's chances of a fair outcome. Trustees may want to increase the frequency and intensity of covenant monitoring if the perceived risk increases and to review the position of the scheme in a distressed scenario, again highlighting the need for specialist advice.

A review of investment strategy and risk exposure is also suggested to try to avoid crystallisation of short term losses. Other employer creditors may take the opportunity at a time of heightened default risk, to negotiate improvements in their own security which may result in detriment to the scheme. To understand the impact on the scheme, trustees should understand changes to the employers capital structure and any refinancing before they become final.

As has been raised in previous TPR guidance, a distressed employer may seek easements from the scheme, including deferral of DRCs. Trustees are reminded of the need to understand the position of the scheme and the employer and to engage in open discussion with the employer to ensure fair treatment. Trustees may wish to seek other forms of security. Specialist advice is advocated, particularly where the employer seeks to release security over an asset.

The importance of open dialogue between the scheme and the employer is discussed. Trustees should be aware of information being produced by the employer and aim to align their own information requests where possible. An information sharing protocol is suggested and also non-disclosure agreements where the employer has any concern around sharing sensitive information. Trustees should be aware of the impact of any corporate transaction which could damage the employers ability to pay contributions or reduce value available to the scheme in the event of insolvency, seeking mitigations where appropriate and consulting the Regulator and the PPF where necessary (i.e. if a RAA or CVA is being considered).

The guidance also considers trustee communications with members during periods of corporate distress, noting that a previously agreed communications strategy is helpful in managing members worries. If members become concerned, they may request transfers which might not be in their best interests and may expose them to the risk of scam activity.

If the sponsor is facing the prospect of insolvency, trustees will want to ensure (with advice) that all options for scheme protection have been explored and consider enforcement options. Practical steps for preparing for PPF entry are noted.

TPR's guidance recognises the influence of the Corporate Insolvency and Governance Act ("CIGA") from 26 June 2020, focusing on business rescue and survival. The rules are complex and there may be new risks to address; specialist advice is recommended. Trustees should seek copies of any employer turnaround plans to understand their impact, with advice.

Appendices are included outlining the legal obligations to the scheme, warning signs of corporate distress and two case studies highlighting how corporate activity can impact a scheme's position.

Overall, the guidance, which has received a positive response from the industry, does not present any radically new proposals and would not change what trustees are typically doing to protect their members' savings. However, it serves as a reminder to trustees of their responsibilities and is useful in bringing themes we have seen in other initiatives together in a single piece of guidance.

TPR: Guidance on COVID-19

Recognising the unprecedented challenges posed by the current COVID-19 situation, TPR has issued guidance including some regulatory easements. TPR is monitoring the situation and working with government, regulators and others to assess the most immediate risks whilst reaching out to trustees, administrators and employers who are concerned about their schemes. Regulatory initiatives have been suspended and events postponed or cancelled. The relationship supervision cycle has been scaled back with TPR contacting schemes to understand how risks arising from COVID-19 will be mitigated. Schemes will be contacted again over the Autumn of 2020. Several expected publications have been postponed including the consultation on the Single Modular Code. The DB funding code consultation deadline was extended until 2 September and we await the findings. This article looks at some of TPR's key themes. It is not intended to provide a comprehensive guide and scheme specific advice should be taken.

TPR recognises that the current situation is placing strain on scheme administration with levels of service affected and breaches occurring.

Trustees are advised to contact their administrators to discuss the providers' contingency arrangements and to ensure activities critical to the running of the scheme continue. Critical processes are defined as paying member benefits, retirement processing, bereavement services and processes required to ensure benefits are accurate (such as DC contribution investment).

Trustees are urged to work flexibly with administrators to ensure prioritised services are maintained, for example, by altering operating procedures (such as allowing electronic signatures), maintaining higher cash balances and keeping non-critical requests to a minimum. The risk of scam activity is also raised. In turn, administrators should notify trustees of affected services and keep a record of non-priority queries to action once resources are available.

TPR has issued further pieces of guidance for employers and trustees.

Guidance aimed at employers looks at DB scheme funding. TPR expects employers to be open with scheme trustees, providing adequate time and information for them to make a considered response.

A further piece of guidance is directed towards DB trustees, looking at funding and investment issues.

Trustees will need to engage with the employer and enhance covenant monitoring over the short to medium term.

The guidance suggests lines of enquiry for the trustees, around consideration of the impact of the situation on product demand, the assumptions behind forecasting, key payment dates and impacts on cashflows. Financing considerations are noted with, inter alia, enquiry around available borrowings and banking covenants. Trustees are encouraged to assess any other support which may be available to them, such as contingent assets, in line with TPR's existing Integrated Risk Management guidance.

Employers requests to suspend or reduce contributions are also covered. Although not many schemes were initially affected, it is possible that initial or extension requests may be made in the coming months, particularly as employer loan and banking covenant tests are impacted. Trustees may now have greater understanding and visibility of the employer's position and more detail around the business case for any suspension or reduction of contributions. Trustees should ensure that any agreement is in members best interests and is equitable for the scheme.

TPR: Guidance on COVID-19 (cont.)

TPR recognises that extension or a suspension may be appropriate but make clear that they do not expect a rolling arrangement and the suspension becoming the new 'normal' position.

Due diligence should be performed before agreement to any new suspension or reduction, enabling trustees to decide whether any deterioration is temporary or otherwise, potentially signalling a need for a new actuarial valuation.

Guidance indicates that trustees should put protection and mitigations in place where a suspension or reduction is accepted. Possible actions include:

— ensuring cessation of all corporate distributions

— agreement of triggers to recommence contributions

— agreement of legally enforceable creditor payment priority order

— fully understanding the terms of any refinancing involving variation to scheme contributions

— receipt of appropriate information to facilitate enhanced monitoring of the employer, and

— repayment of contributions due within the current recovery plan timeframe. Recovery plans should not be lengthened unless covenant visibility is good and professional advice sought.

Further short term suspensions may be appropriate even where there is little information available from the employer (less information indicating that shorter extensions would be appropriate) although trustees should be aware of variation to substantial payments, ensure compliance with their fiduciary duties and only agree where other creditors are also making concessions.

Requests for trustees to release security are also discussed, such requests rarely being in members best interests. Again, trustees should ensure equitable treatment for the scheme in such scenarios.

Trustees finalising valuations do not need to change the assumptions used but will need to understand recent experience in finalising a recovery plan. TPR accepts that such considerations may take time.

Recent market conditions, and consequently funding positions, have been highly volatile. Uncertainty and risk remain and trustees, with advisers, need to review the impact on their investments, including:

— review of expected cash flows, and variations to them

— amendments to investment strategy or mandates

— investment diversification

— derivative holdings

— counterparty exposures

— pre-agreed portfolio changes

— delegations and subcommittee operating procedures

— actions protecting members benefits in the event of employer difficulties

— trustees' IRM policy and monitoring, and

— investment and risk governance arrangements.

TPR: Guidance on COVID-19 (cont.)

Trustees may also wish to take advantage of some of the opportunities afforded in the current market.

TPR's guidance recognises that trustees may need to make difficult decisions and, in doing so, need to balance risks to the scheme against the benefits of supporting the employer. Protections should be sought to secure members best interests. Trustees may feel it appropriate to take relevant advice, particularly where competing demands are being made on the employer. Trustees are reminded to obtain relevant information, take advice where appropriate, adhere to provisions of the trust deed, make decisions in good faith and document decision-making and conclusions.

DB transfers are also noted with TPR recognising increased activity volumes and that delays may occur in finalising calculations. Guidance highlights possible extensions to allowable time frames and the risk of scam activity.

In the event of a breach, trustees should report to TPR – see later article on regulatory activity. TPR expects compliance with reporting requirements from 1 July emphasising that they cannot waive the obligation to submit recovery plans or report agreements to suspensions or contribution reductions which should be reported together with supporting documentation.

Separate guidance from TPR looking at auto-enrolment and DC pension contributions notes that employers' duties continue as normal and considers how the Government's support scheme integrates with this.

Further guidance for trustees looks at DC investments. Whilst stressing that the guidance does not override any legislation or scheme governing documentation, it expects trustees to 'do the right thing' for members and aims to support trustees by highlighting good practice.

The guidance acknowledges that, although they are invested for the longer term, members may have suffered heavy losses and may make inappropriate decisions crystallising those losses. There is also a danger of members opting out of schemes if earnings are reduced or if they are offered an attractive opportunity by scammers. Transfer activity, which should continue as it is deemed a 'core financial transaction', may also attract scammers. TPR recommends that trustees review their member communications highlighting these concerns and outlining what market volatility might mean to members, warning of the scam danger and encouraging members to seek advice.

The current market will present specific risks to portfolios and service providers which trustees will need to review and manage, for example, potentially suspending or refining any rebalancing and improving diversification of the investments held. Consideration should be given to the level of exposure to counterparties and timing of proposed transactions. If contributions are being diverted to a fund other than that selected by the member, a default fund may have been created. In this situation, trustees need to ensure that all default fund requirements are met.
Trustees will need to review scheme governance, in particular concerning continuity in the event of trustee unavailability, sub-committee operation, quora of meetings, delegations and authorisations. The trustees may wish to take this opportunity to review their longer term risk management arrangements and governance planning, and ultimately whether their membership would benefit from a transfer of benefit provision to a larger arrangement.

TPR: Guidance on COVID-19 (cont.)

The current market conditions could present opportunities. Trustees may wish to consider developing governance and investment arrangements to embrace these changes.

Trustees may be faced with sponsoring employers unable to make contributions to their scheme. As long as auto-enrolment requirements are not breached, and the scheme documentation allows, such reductions are generally permissible. Where the employer has at least 50 employees, consultation is required.

TPR has issued guidance that, if certain criteria are met (mainly that the employer is only proposing to reduce contributions for furloughed staff), then a regulatory easement will apply if the employer fails to consult for the required 60 days.

If a rule change is being considered and the power to do this rests with the trustees, trustees will need to ensure that this is in the best interests of scheme members before proceeding.

We will keep you updated on further guidance in future editions of Round-up.

TPR: Guidance on COVID-19 - regulatory aspects

TPR has updated guidance in relation to its regulatory and monitoring activities which adopts a more flexible approach to expected reporting and enforcement. Following easements originally introduced for the period to 30 June 2020, the requirement to report resumed from 1 July. This includes reporting for:

- Suspended deficit repair contributions,
- Late valuations or outstanding recovery plans,
- delays in CETV quotations or payments,
- Late audited accounts, and
- Master trusts.

TPR's guidance separately considers schemes in relationship-managed supervision, noting enhanced focus on near-term risks rather than standard activities. Such schemes will be approached individually. For other schemes, regulatory activity will be informed through assessment against risk indicators. The Regulator has stated that its general approach will be to 'assess breaches of administrative and compliance requirements on a case-by-case basis and respond pragmatically where these breaches are COVID-19 related.'

TPR's approach in certain areas of regulatory activity is clarified in the guidance. It is worth noting that the easements noted are fewer than in the original version of this guidance.

Chair's statements

TPR will continue to impose fines for non-compliance with the requirements for preparation of a chair's statement because the legislation does not give any discretion in relation to enforcement.

TPR will revert to reviewing chairs' statements submitted on and after 1 October as usual (unless schemes are notified otherwise). In an earlier easement, TPR had returned chairs' statements unreviewed. As statements were returned unread, this was not to be taken as a sign of compliance.

Note also that TPRs normal approach to enforcement in relation to late preparation of audited accounts resumed from 1 October.

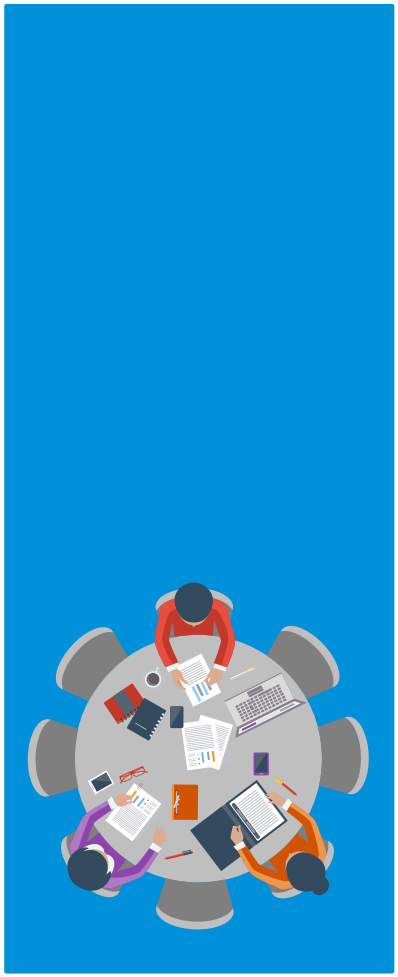
Investment governance

From 1 October 2020, TPR resumed their normal approach to enforcement for non completion of SIP reviews.

Late payments of contributions

TPR have confirmed that from 1 January 2021, reporting of payment failures that are 90 days late should resume, rather than the 150 days allowed in an earlier easement.

GMP equalisation update - historic transfer values



On 20 November 2020, the High Court handed down a further judgment on the GMP equalisation case relating to the Lloyds Banking Group. The latest judgment considers the treatment of historic transfer values, an issue which was explicitly excluded from the 2018 judgment.

The 2018 ruling created a legal obligation (from the date of the ruling 26 October 2018) on scheme trustees to equalise GMPs through other scheme benefits. Equalisation includes backdating of benefit adjustments and related interest to 17 May 1990, subject to scheme rules which may have a 6 year limit.

Following the recent ruling, UK DB schemes will have an additional obligation in respect of unequalised historic transfers paid out. Trustees will need to pay out the correct amounts and are expected to be proactive in considering how they will deal with this issue. Former sponsors of contracted out schemes that have wound up may need to take legal advice to understand where the liability sits and consider whether it is appropriate to book a contingent liability.

Under FRS 102 and the Pensions Statement of Recommended Practice ("SORP"), these obligations need to be recognised as a liability in pension scheme financial statements for year ends after the respective judgement dates, subject to materiality considerations.

Trustees may wish to undertake an initial high level assessment of the likely liabilities with a view to undertaking detailed calculations only if the amounts are not clearly immaterial. It may not be necessary for trustees to include immaterial amounts in the financial statements although they may choose to do so along with an explanation of their approach and accounting in the trustees' report.

Trustees will want to consider the implications of the judgements for their scheme, seeking professional advice and considering in detail which benefit equalisation method, of the several suggested by the court, will be applicable and the likely costs. This will include liaising with the employer.

The calculations involved will be complex and the detailed member information required may not be available in time for the preparation of the financial statements. In such cases it may be possible to use other methods to obtain a view of the likely financial impact on the scheme. Note that the Department for Work and Pensions ("DWP") published guidance on the use of GMP conversion legislation on 18 April 2019, which sets out how schemes could use GMP conversion legislation to equalise benefits.

Trustees should endeavour to determine a reasonable (best) estimate for the cost of backdated benefits and related interest for inclusion in the financial statements.

However, it is possible that calculations based on the agreed approach are not finalised at the time of preparing the scheme financial statements and/or detailed calculations have not been fully completed. If the trustees conclude that it is impossible to determine a reliable estimate and there are grounds to believe the amounts are likely to be material this should be disclosed in the notes to the financial statements and treated as a contingent liability (rather than an accrual or provision).

GMP equalisation update - historic transfer values (cont.)

Both parties to the Lloyds case agreed that equalisation applies to benefits transferred in. In other words a receiving scheme will need to make good any inequalities in benefits arising from transfers in. Any de-minimis consideration was deferred to a further hearing.

Disclosures and balances included in the financial statements as a result of the GMP equalisation ruling will be subject to audit scrutiny. The nature and extent of audit work required will depend on the uncertainty and complexity of any estimates required and disclosures made.

Further guidance is available from the Pensions Research Accountants Group ("PRAG"), including suggested disclosures covering various scenarios. However, it is clear that early liaison between trustees, scheme auditors, scheme actuaries and the employer is key to assessing the implications and likely impacts on pension scheme financial reporting. For an outline of the wider considerations and possible trustee responses see the summary attached.

DC Consultation: Improving outcomes for members of defined contribution pension schemes

The Government has issued a response to their earlier consultation 'Investment Innovation and Future Consolidation' this month together with a further consultation on regulations and statutory guidance. The new consultation ran to 30 Oct 2020.

Guy Opperman has stated that the government has *'an aspiration that all Defined Contribution (DC) scheme members should benefit from efficient and operationally resilient administration, first class investment governance, and access to innovative and diversified investment strategies. .... want all scheme members to benefit from a broader range of assets to improve the returns they achieve, and to drive new investment in important sectors of the economy.'*

The new document, entitled improving outcomes for members of defined contribution pension schemes, includes consultation on a number of broad areas and proposals for regulations and guidance. Aspects being consulted on include new statutory guidance on assessment of value for members.

In summary, the proposals made centre on the key topic areas noted below.

Consolidation

Consolidation of smaller schemes is seen as the most effective way for members to take advantage of benefits of scale including the ability to invest in a broader range of investments including illiquid and alternative investments, which may be unavailable to small schemes. The consultation notes that TPRs register holds some 3,000 DC schemes, of which approx. 2,000 have less than 100 members and 1,300 less than 12 members. Such schemes may expose members to higher charges and poorer standards of governance – this is borne out by TPR data.

Under the new regulations, expected to be in force on 5 October 2021, small schemes offering higher standards will be able to demonstrate their value to members. Schemes offering low value for members will be expected to wind up and consolidate into larger schemes. It may be possible for schemes to improve if trustees are confident that this is realistic in a reasonable period and would be cost effective or if valuable guarantees would be lost should the scheme consolidate. However, taking into account the time, skill, capacity and costs involved, wind up may still be a better option. The trustees chosen route is reportable to TPR who have the power to intervene should the need arise.

The consultation proposes that the new value for members assessment applies for schemes with less than £100 million in total assets and which have been operating for at least 3 years. In addition, schemes of all sizes will need to publish net returns for their default and self-select funds in their annual DC chair's statement.

A value for money assessment will need to be conducted annually, be included in the schemes DC chair's statement and cover the following:

— costs/charges and net returns (assessed relative to 3 comparative schemes)

— measures of administration and governance (assessed absolutely) which include:
  - promptness and accuracy of financial transactions;
  - appropriateness of default investment strategy;
  - quality of investment governance;
  - quality of record keeping;
  - quality of communication with members;

DC Consultation: Improving outcomes for members of defined contribution pension schemes (cont.)

- level of trustee knowledge, understanding and skills to run the scheme effectively (assessed across the trustee body as a whole); and
- effectiveness of management of conflicts of interest.

Trustees will need to include the outcome of their assessment in their annual return and any necessary consequential actions.

The consultation seeks views on reporting of net returns – i.e. an appropriate period of look back, on whether the proposals encourage consolidation and on whether sufficient clarity is given on expectations on assessing and reporting value for members.

Diversification, performance fees and the default fund charge cap

The Ministerial foreword notes that *'Trustees' fiduciary duties require them to take account of all long term financially material considerations when deciding their investment policy…. It is …Government's policy to ensure it is not putting up unnecessary or inadvertent obstacles to trustee decisions where these would limit trustees' ability to take full advantage of the broad range of asset classes available to them.'*

The consultation proposals aim to remove barriers to investment in more diverse instruments by addressing the measurement of performance fees and the charge cap. It proposes measures, to be effective from 5 October 2021, in three areas.

— Better enabling schemes to pay performance fees

When assessing the charges that scheme members have paid against the charge cap (which will be pro-rated for the part of the year a member has been in the scheme), trustees will exclude the performance fee element, if it is accrued each time the value of the investments is calculated.

A multi-year smoothing period is proposed as an alternative option in calculating performance fees to facilitate investment in a wider range of illiquid assets.

— Excluding the costs of holding 'physical assets'

Extant guidance notes that the costs of holding physical assets, such as real estate or infrastructure, are not included within the charge cap. The consultation puts that exclusion on a statutory footing.

'Physical assets' are defined as: an asset whose value depends on its physical form, including land, buildings and other structures on land or sea, vehicles, ships, aircraft or rolling stock, and commodities.

The proposals remove costs attributable to holding physical assets from the charge cap and provide a non-exhaustive list of excluded costs.

— Updating charge cap guidance to clarify treatment of underlying costs in investment trusts.

The consultation proposes clarification of the costs and charges included in the charge cap, indicating that schemes should look through all open-ended funds and all UK listed closed-ended investment funds and international equivalents to the underlying costs.

Other changes to legislation

Further amendments noted below are proposed to be in force from 05 October 2021.

DC Consultation: Improving outcomes for members of defined contribution pension schemes (cont.)

— Extending the requirement to produce a default Statement of Investment Principles ("SIP") to 'with profits' schemes

Because of the way the regulations providing for a default SIP requirement were drafted, no scheme with a benefits 'promise' (such as an older 'with profits' policy) is required to produce a default SIP. This is not in line with Government policy and proposals will require such schemes to produce a default SIP.

— Extending the costs disclosure requirements to funds which are no longer available for members to choose

Proposed amendments would extend the requirement to show charges and transaction costs to all funds which members are, or have historically been, invested.

— Excluding wholly insured schemes from some requirements of the Statement of Investment Principles

This measure supports a long standing exemption of wholly-insured schemes from the need to produce most sections of the SIP as the trustees have no discretion over the investment of the scheme's funds.

Updated reporting of costs, charges and other information: statutory guidance

The current consultation also proposes statutory guidance providing additional clarity on disclosure of costs and charges information. With the intention of making the disclosure of the impact of costs and charges simple and clear, it is suggested that:

— an illustration should be produced for each individual employer's default fund, but the scheme need only produce an illustration of: the default fund, the lowest charging self-select fund and highest charge self-select fund offered. Additional illustrations are encouraged where these would be useful to members.

— in schemes with multiple defaults:
  – the pot size used should be a median across the whole scheme,
  – the real-terms investment return only needs to be shown for each fund or arrangement for which an illustration is provided.

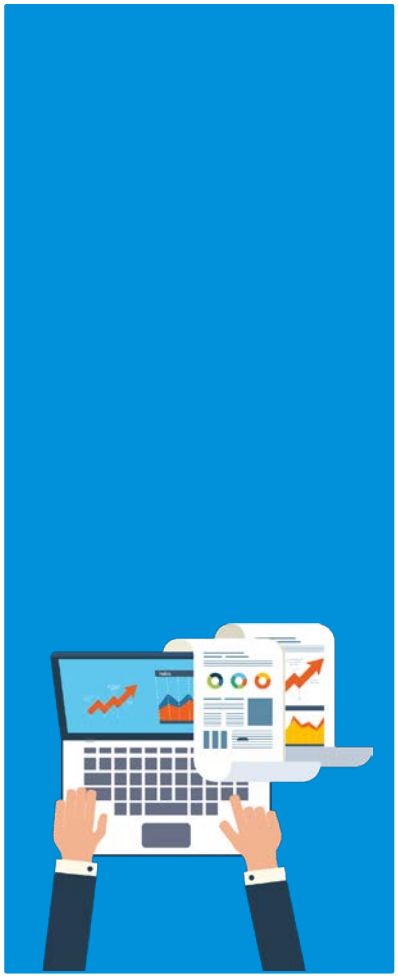
— the Statement of Investment Principles, the Chair's Statement (inclusive of charges and transaction cost information, value for money assessment and default SIP), and the relevant section of the Annual Report (the implementation statement) do not necessarily have to be produced as a single web-page or PDF document.

— when the Chair's Statement is circulated in print format, it can simply be a collation of all the relevant documents.

Industry reaction

TPR has welcomed the proposals stating that the initiatives around consolidation are in line with TPR's own aims – i.e. to ensure that all savers are able to access well run schemes which provide good value for money.

The Pension Schemes Bill



Guy Opperman has recently suggested that he expects the Pension Schemes Bill to become law by the end of 2020. The Pension Schemes Bill ("The Bill") completed its Report Stage and Third Reading in the House of Commons on 16 November and will now go back to the House of Lords for further consideration. The Bill, as originally highlighted by the Queen's Speech, aims "…To help people plan for the future, measures will be brought forward to provide simpler oversight of pensions savings. To protect people's savings for later life, new laws will provide greater powers to tackle irresponsible management of private pension schemes."

The main elements of The Bill were initially drafted as:

— Providing a framework for the establishment, operation and regulation of Collective Defined Contribution schemes;

— Strengthening the Pensions Regulator's powers and the existing sanctions regime. This will include introducing new criminal offences, with the most serious carrying a maximum sentence of seven years' imprisonment and a civil penalty of up to £1 million;

— Giving the Regulator enhanced powers to obtain the right information about a scheme and its sponsoring employer in a timely manner, backed up by penalties;

— Providing a framework to support pensions dashboards, including new powers for the Regulator which will include penalty fines, to compel pension schemes to provide accurate information to consumers. This will include provisions to amend the Pensions Act 2004 and to ensure relevant schemes comply;

— Creating regulations to set out circumstances under which a pension scheme member will have the right to transfer their pension savings to another scheme;

— Improving the defined benefit scheme funding system by requiring a statement from trustees on their funding strategy; and

— Amending the legislation for the Pension Protection Fund compensation regime to enable the Fund to continue to apply the compensation regime as intended and amend provisions relating to administration charges.

A further provision has subsequently been added requiring schemes to adopt and report against the recommendation of the Task Force on Climate-related Financial Disclosures ("TCFD").

The Government have indicated their intent to introduce further measures against scams.

Industry reaction

Various industry commentators have welcomed the proposals. However, some disappointment has been voiced over the lack of any provision for a defined benefit consolidator or Superfund regime. Guy Opperman has recently suggested that a second Pensions Bill, which may look at Superfunds, is to be expected within the current Parliament.

TPR: Defined benefit funding code of practice - consultation

The first part of TPRs two part consultation on a proposed new funding regime closed on 2 September. The consultation was broadly welcomed. However, it is acknowledged that much of the detail remains outstanding until the second part of the consultation is published, including assessment approaches and the regime's application to large multi-employer arrangements. Some concern was raised around the regime becoming too prescriptive and potentially leading to a worsening situation for members and that schemes may be encouraged to 'level down' to FastTrack from currently higher standards.

Issued in March 2020, this first consultation looks at the framework of the revised provisions and the second will apply more detail about what the new Code and guidelines might look like. TPR is keen to understand any practical considerations and highlight any unintended consequences and also to form a view of 'what good looks like'.

The proposals introduce a new framework aiming to achieve a balance between security of member benefits and affordability to the employer, building on already familiar themes such as integrated risk management and long term planning.

Compliance with the proposed new approach is not likely be overly onerous for a well-run scheme, but is intended to improve the governance of those schemes currently taking an excessive amount of risk with their funding position. The new framework will rest on a series of key principles:

Compliance and evidence

Trustees will be expected to understand their scheme specific funding and investment risks and evidence how these risks have been assessed as acceptable and managed, comparing any risk to a tolerated risk position and demonstrating mitigation / support available.

Long term objective ("LTO")

Mature schemes will be expected to be resilient to risk and have low dependency on the employer (a lower risk of requiring significant support).

Journey plans and technical provisions ("TP")

Trustees should formulate a journey plan, linking to and aligning with TPs, to a LTO with decreasing investment risk.

Scheme investments

A scheme's investment strategy should be aligned with its funding strategy and have sufficient security, quality and liquidity considering both expected and unexpected cash flows. At maturity the asset allocation should have high resilience to risk, a high credit quality and level of liquidity.

Reliance on the employer covenant

A reducing reliance on the employer is expected over time.

TPR: Defined benefit funding code of practice - consultation (cont.)

Reliance on additional support

Schemes will be able to take account of additional support in valuations, provided that the support is provided at the right level to mitigate risks taken, it is valued appropriately and is legally enforceable and realisable.

Appropriate recovery plan ("RP")

Scheme deficits should be recovered as soon as they are affordable without compromising the sustainable growth of the employer.

Open schemes

The security of members' benefits is equally important in both open and closed schemes. Note that on 30 June an amendment to the Pension Schemes Bill was made requiring different approaches to regulation of open and closed DB schemes on the basis that 'the liquidity profile of an open and active scheme.....is very different from a closed scheme'.

A new regulatory approach: Fast track and Bespoke

Proposals in the consultation aim for greater direction to be provided, without being overly prescriptive. A twin track approach to valuation compliance is proposed – referred to as 'Fast Track' and 'Bespoke'. It is hoped that this approach will provide greater clarity on the expected standards to trustees, employers and their advisers. Evidence supporting adoption of either route will need to be submitted to TPR as part of the new statement of strategy introduced by the Pensions Bill 2020.

Schemes may switch between the two tracks at different valuations, recognising that scheme and employer circumstances may change over time.

Fast Track

The consultation document headlines the fast track approach as providing a streamlined route to compliance with the legislation comprising straightforward quantitative compliance.

If requirements are complied with, less evidence will be needed and minimum regulatory involvement can be expected.

The Fast Track route is relevant for schemes whose valuations comply with all aspects of TPR's requirements which, whilst not intended to be risk free, will represent a 'baseline of tolerated risks'.

Bespoke

This option provides more flexibility for valuations of schemes who cannot or who are choosing not to adopt the Fast Track approach to incorporate scheme and employer specific circumstances.

However, valuations adopting this approach will need to be more fully articulated and evidenced and may involve more regulatory involvement.

There are varied reasons for not adopting the Fast Track approach and the Bespoke approach is equally compliant with the legislation. A higher level of regulatory involvement can be expected as schemes will have to demonstrate how and why their approach differs from Fast Track and how any

TPR: Defined benefit funding code of practice - consultation (cont.)

additional risk is being managed. It is intended that Bespoke arrangements meet the key principles of the Fast Track standard whist allowing for additional flexibilities. For example, if additional risk on funding is accepted by trustees, there would be a need to demonstrate how that risk is managed which could involve, inter alia, putting contingent asset arrangements in place. TPR would expect such assets to be appropriately valued and be legally enforceable and accessible when needed.

Fast Track: key principles and options

Employer covenant

Balancing the needs of scheme members and the costs to employers is paramount. A higher degree of reliance on the employer may be justified, for example, for an immature scheme taking higher risks; the scheme then transitioning to a lower dependence position over time. TPR's second consultation will deal with the detail of this balance. Schemes with a stronger employer covenant may be in a position to take more risk.

The consultation looks at how covenant support should be integrated, recognising that visibility does not typically extend to beyond 3-5 years.

Assessment of the covenant is also considered looking at two options: the current 'holistic' approach or a simplified model resulting in a calculated value or metric. Retention of the current covenant grading system is proposed but views are sought on increasing the number of ratings.

Long term objective

The proposals indicate that, as they mature, schemes should seek to reduce reliance on the employer covenant and hold an asset portfolio which is resilient to risk. Once an LTO is identified, trustees can formulate a strategy to reach this 'end game' position whether that is to buy out, consolidate or run off the scheme. Views are sought on the definition of an LTO and assumptions relating to members benefits for those on the Fast Track route.

Journey planning and technical provisions

The 2020 Pension Schemes Bill requires technical provisions to align to the LTO. A journey plan sets out how schemes will achieve their destination LTO. This may not happen in a short timeframe. Technical provisions will not always match the LTO but should measure progress along a smooth journey plan towards it and will reflect the discount rates and investment strategy along the way. Once a scheme is fully funded on a TP basis, TPR would expect schemes to invest in accordance with their journey plan to move themselves towards a position of low dependency on the employer, introducing a recovery plan only if a deficit arises on a TP basis. The consultation seeks views on an appropriate journey plan 'shape' for Fast Track TPs, how much covenant reliance should be embedded and how to express fast track TPs and derive guidelines.

TPR: Defined benefit funding code of practice - consultation (cont.)

Scheme investments

The consultation suggests that a scheme's investment strategy and asset allocation over time should be broadly aligned with the funding strategy. Trustees will need to ensure that this strategy has appropriate security, quality and liquidity. TPR suggests proposals on how trustees may be able to demonstrate that risks in their investment strategy are supported. Options are outlined on a suitable reference point for measurement of investment risk, how to measure risk, and the definition of an acceptable level of risk at different scheme maturities and covenant strengths. Credit quality and liquidity guidelines for the Fast Track route are also considered.

Appropriate recovery plans

Affordability is key in considering recovery plans. TP deficits should be recovered as soon as possible whilst minimising the impact on employer growth. A balance is sought between risks to the scheme and flexibility for employers in managing cash flows. Evidence of affordability constraints will be required where longer recovery plans are proposed.

In such cases trustees will be expected to put in place suitable mitigations. Consultation responses are sought on appropriate recovery plan lengths and whether these should vary depending on the employer covenant.

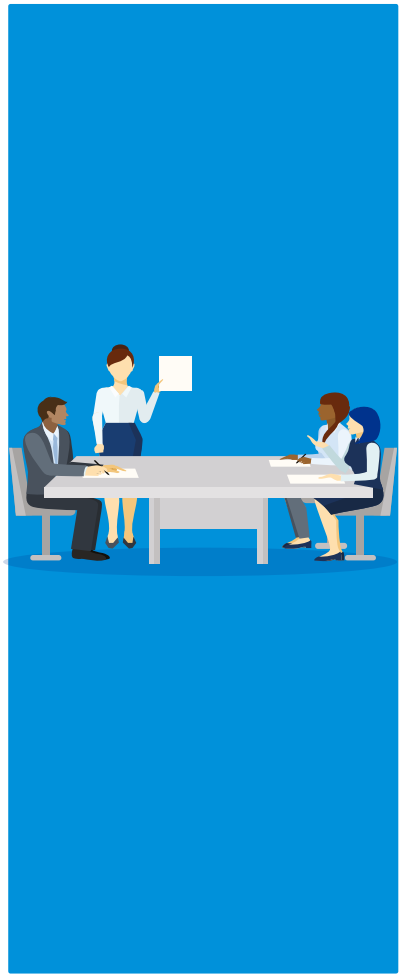
Open schemes

Open schemes mature more slowly (or not at all) as compared to closed schemes. However, the accrued rights of members in open schemes should have as much security as those in closed schemes. The consultation proposes to treat past service liabilities (TPs) and future accrual separately with all schemes having the same LTO of funding based on low employer dependency once they are more mature. The consultation seeks views on the method of calculation of TPs and the cost of future service benefits for open schemes.

To conclude:

The consultation will be followed by a second consultation in 2021 which will incorporate feedback received in the current document. **(see earlier article: The Pensions Bill)**

Investment disclosures, climate change and latest developments



The requirement to produce an implementation statement is now a well known requirement of the annual report and accounts and trustees will be aware that a scheme's first statement must be published online by 1 October 2021 at the latest, if not already done so.

Previous articles in Round-Up have focussed on the regulatory requirements of these statements, but as we now begin planning for the 2021 accounts preparation and audit cycle, this Edition looks at some practicalities and our experience to date.

For many schemes with 31 March 2020 or 5 April 2020 year-ends, the accounts and audit timetable were brought forward this year, with the aim of signing off prior to 30 September 2020. This therefore meant that production of the first implementation statement was "delayed" until the 2021 annual report. The impact of this, however, is that an earlier timetable will have to be repeated for the next year to ensure the annual report and accounts are signed and the statement published online prior to the deadline.

The implementation statement must be published online – for relevant schemes as soon as the first annual report and accounts are signed after 1 October 2020, and by 1 October 2021 at the latest, and for defined benefit schemes by 1 October 2021. Once published, trustees may find themselves under greater scrutiny from members, the public and regulators and therefore the statement should not be treated as a tick box exercise.

The key will be adequate planning and early discussions with advisers and auditors, to ensure deadlines are met.

For more information on the requirements for your annual report, and a more detailed summary of the key points set out in the implementation statement guidance produced by the Pensions and Life Savings Association ("PLSA"), look out for our publication "Implementation Statement Guidance" which can be obtained from your usual KPMG contact or from our website.

Task Force on Climate Related Disclosures recommendations

It is important to note, increased investment disclosures will not end with the implementation statement. Once the Pensions Bill receives Royal Assent, the DWP have proposed to introduce new regulations to map the Task Force on Climate Related Disclosures (TCFD) recommendations into pensions law, accompanied by statutory guidance. In August 2020, the DWP issued a consultation "Taking action on climate risk: Improving governance and reporting by occupational pension schemes" to legislate for the recommendations of the Task Force. Increasing transparency by mandating these enhanced disclosures will require scheme trustees to embed climate change as a financial risk in their governance and risk management processes as well as in their investment strategies.

Investment disclosures, climate change and latest developments (cont.): TCFD recommendations

Governance	Strategy	Risk Management	Metrics and Targets
a) Describe the board's oversight of climate-related risks and opportunities	a) Describe the climate-related risks and opportunities the organisation has identified over the short, medium, and long-term.	a) Describe the organisation's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.	b) Describe the organisation's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas emissions, and the related risks.31
c)	c) Describe the resilience of the organisation's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organisation's overall risk management.	c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets

To underpin the recommendations, the Taskforce developed seven Principles for Effective Disclosures;

1. Disclosure should represent relevant information;
2. Disclosures should be specific and complete;
3. Disclosures should be clear, balanced and understandable;
4. Disclosures should be consistent over time;
5. Disclosures should be comparable among companies within a sector, industry, or portfolio;
6. Disclosures should be reliable, verifiable and objective; and
7. Disclosures should be provided on a timely basis.

Investment disclosures, climate change and latest developments (cont.)

Concluding comments

All pension schemes are exposed to climate-related risks (and opportunities), regardless of their investment portfolios; passive, active, growth or matching. What is also important to note is the fact that sponsoring employers also face the same challenges.

There is an abundance of proposed change coming from policy-makers and regulators and although best practice will evolve over time, trustees must educate themselves now. There is much information and guidance already available. Good member outcomes require effective governance and decision-making processes and trustees will need a clear strategy to navigate climate change and ESG risks and opportunities.

Consultations on regulations and statutory guidance is expected early in 2021 with an effective date for the regulatory requirements set for October 2021.

PASA: COVID-19 Guidance: The Road Ahead

In August, The Pensions Administration Standards Association ("PASA") released new guidance, 'COVID-19 Guidance: The Road Ahead' considering that, as restrictions due to lockdown ease, scheme administration is still operating in a very different way.

Overall, administrators have coped well with the crisis, perhaps the larger more so than the smaller. Now much will depend on the way firms implement their 'back to office' return plans, which will vary firm to firm.

PASA highlight that scheme visibility on the internet is key, particularly if remote working becomes the norm as postal and printing services will impact paper based solutions. A 'trilogy' of 'good data / web / email addresses for members' is noted as being essential to the delivery of efficient services. The guidance recognizes that there is still a proportion of the population who do not engage digitally and administrators need to ensure these people are not 'lost'. PASA suggest key questions for trustees here including assessing their communications strategy to ensure, inter alia, it is multi channel – i.e. phone, post and digital, assessing actions needed to ensure access for all and supporting this through data cleansing and benefit testing.

The guidance goes on to consider workflow, noting that for remote working to succeed, all records need to be electronic and all data cleansed (a key requirement of the Data Protection Act accuracy principle). The pandemic has shown that accurate member email addresses and mobile phone numbers are important; particularly in times of crisis.

Risks posed by cybercrime, fraud and error are also noted. Administrators should seek to confirm the accuracy of any manual calculations performed and track workflow through the lockdown period. The guidance suggests several questions directed towards administrators to enable them to appraise their position as they will need to return to full work strength as lockdown eases. Enhanced Management Information (MI) may have been made available to trustees during lockdown; this should continue if it facilitates good scheme governance. Lessons learned during lockdown should be incorporated into BCPs and consideration given to the practicality of offshore arrangements going forward.

Issues raised by restrictions around face to face meetings are also discussed – suggesting that perhaps technological improvements may offer enhancements, such as shortened meetings and virtual office tours.

The urgency of improved ID security is stressed – noting that the admin sector has traditionally lagged behind in this area in its reliance on paper documentation. Similarly, if lockdown has proved that digital signatures for investment management purposes have been a success, there is no reason why these should not continue to be used going forward. Administrators should include AVC managers and insured arrangements in any future lockdown contingency planning.

Employee wellbeing, collaboration, coaching and the need for continued training are also emphasized. This extends to recruitment, with some administrators surveyed by PASA not recruiting where there was a need to do so – something which could impact on the wellbeing of other team members.

PASA conclude that where COVID-19 has forced changes resulting in enhanced efficiency, then it is likely that these changes could be made permanent. This includes making use of technological solutions meeting differing member needs. Administrators will need to consider whether, and to what extent, flexible working will remain post COVID-19 and how their integral processes and technology will adapt to this new environment.

News in brief

TPR Corporate Strategy

Following industry input, TPR has released a consultation setting out its corporate strategy over the next 15 years. The document is intended to be living and will evolve. Since TPR was formed, ways of working have evolved; the new strategy recognises that varying retirement provision is appropriate for different groups, also noting external drivers for change such as the pensions dashboard initiative and climate risk. TPR intends to build on their clearer, quicker and tougher approach with focus and flexibility to meet future challenges.

The emphasis is on the saver, ensuring that savings outcomes are protected, particularly with the increased prevalence of DC provision where they are driven by the right contributions being invested at the right time and in the right place whilst delivering value.

The strategy considers savers by age cohort (Baby Boomers, Gen X and Millennials) and income level, noting the profile of likely provision for each group with a tailored approach to the challenges, considering risks and opportunities faced by each group.

Key areas of focus for Baby Boomers will include achieving security and value in DB schemes, preventing and tackling scams and understanding / enabling members in good decision making. The focus areas shift in considering Gen X and Millennials towards participation in workplace schemes, value and security in saving and encouraging and supporting innovation. The strategy also considers the next cohort, Generation Z, recognising that further evolution will be required to meet their needs.

The pensions landscape is also considered with TPR expecting consolidation of all scheme types. Larger schemes will bring their own risks, highlighting the need for an integrated approach between the different regulators. Market trends are identified with the strategy introducing a market map enabling TPR to assess and monitor the impact of any change on other areas of the market and ensuring a coherent approach and value for money.

Five strategic priorities are identified:

Security – considering DB funding, protection from scammers, simplification and security provided by the PPF.

Value for money – focusing on suitable investment, reasonable costs and charges and provision of good quality services driven by robust data.

Scrutiny of decision-making – ensuring that decisions are in members best interests, are fair and transparent and encouraging diversity in decision making.

Embracing innovation – with the aim of collaborating with the market to enhance security, efficiency, transparency, simplicity and choice.

Bold and effective regulation – putting the savers first, driving participation and good outcomes adopting a bold, innovative, flexible and collaborative approach.

Responses are sought to consultation questions by 16 December with an updated strategy forecast for publication in the new year.

News in brief (cont.)

Guidance: COVID-19 and your pension

In October, the PPF together with the Financial Conduct Authority ("FCA"), the Financial Service Compensation Scheme ("FSCS"), the Money & Pensions Service ("MaPS"), the Pensions Ombudsman and TPR published guidance aimed at pension scheme members considering the remit of each of the organisations and how their operations have been affected by COVID-19.

The guidance forms a 'one stop shop' for scheme members wanting to understand the key risks associated with pensions during the COVID-19 pandemic and where they may be able to turn for help. The publication is segmented, with each contributory organisation setting out the scope of their work and key issues relating to their current operations.

Common themes emerge. The risk of scams is prevalent with scheme members urged to reject any unexpected offers of pension reviews, to check who they are dealing with, not to rush into anything and to seek impartial advice.

The MaPS section articulates how pension contributions are made when an employee is affected by the Job Retention Scheme and considers the risks faced by those considering accessing their pension pot from age 55.

The document also points readers towards how to access the resources of the different organisations, as relevant, including the PPF website's 'Retire Now' feature.

Guy Opperman, Pension Minister, offers a foreword recommending the guide as 'a valuable and comprehensive tool for anyone wanting to understand how their pension savings are protected and supported at this moment in time'.

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