KPMG

Pensions accounting, assurance and regulatory round-up

Private sector occupational pension schemes

February 2021

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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The Pension Schemes Act 2021

On 11 February, a date described by Guy Opperman, Parliamentary Under-Secretary of State for Pensions and Financial Inclusion, as "a historic day", the Pension Schemes Bill received Royal Assent, becoming the Pension Schemes Act 2021.

The Act, whose original aim was stated as being to "…To help people plan for the future, …..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", provides a framework with much of the detail following in Regulations. The first of these, looking at climate change disclosures, is already out for consultation but it will be some months yet before all provisions of the Act are in force.

Key themes include new powers for the Pensions Regulator ("TPR"), scheme funding and climate change disclosures, anti-scam provisions and new frameworks allowing the development of pensions dashboards and Collective Defined Contribution ("CDC") Schemes.

TPR

TPR have been given significant new powers.

Contribution Notices

Two new tests have been introduced allowing TPR to issue Contribution Notices ("CN"):

— Employer insolvency test – may be used if TPR is of the opinion that the value of the assets of the scheme is less than liabilities of the scheme and an act or failure would have materially reduced the amount of s75 debt due. Several defences are noted: taking due consideration of the extent to which an act or failure would reduce the amount recovered, taking all reasonable steps to minimise the effects, a reasonable conclusion that debt would not be reduced and the valuation of assets equalling or exceeding liabilities.

— Employer resources test - may be used if TPR is of the opinion that an act or failure reduced the value of resources of the employer and the reduction was material relative to s75 debts in relation to scheme. Defences noted in this situation: due consideration given, taking all reasonable steps, a reasonable conclusion that act or failure would not bring about a reduction in value of the resources of the employer.

Clarification is given as to dates for determining CN amounts. A new criminal offence of failing to comply with a CN is introduced with financial penalties up to £1 million.

New Powers

More controversial new powers are the introduction of criminal sanctions for avoidance of employer debt and for conduct risking accrued scheme benefits. The offence of avoiding employer debt is committed if conduct prevents recovery of whole or part of a debt under s75, prevents such debt becoming due, compromises or settles a debt, or reduces the amount of the debt, with intent and without reasonable excuse. In the case of the offence of conduct risking accrued benefits, an offence is committed if conduct has a material detrimental effect on the likelihood of accrued benefits being received, the person knew or ought to have known conduct would have that effect and had no reasonable excuse. Both new criminal offences attract maximum of a 7 year prison sentence or a fine, or both.

The new offences are very widely drawn. Concern has been expressed by commentators that these provisions may inhibit normal business transactions. It is hoped that TPR will provide clear guidance on interpretation, reach and use of these new powers.

The Pension Schemes Act 2021 (cont.)

However, any indications TPR may give will only be in the form of guidance and will not have the authority of legislation. As a result of this potential uncertainty we may see more applications for regulatory clearance to determine whether proposed business activity is acceptable.

Notifiable Events

The 2021 Act also builds on the content of the 2004 Act in relation to notifiable events, adding detail of when notice is required to be given and by whom. An accompanying statement is required on notifications describing the event, its effects, mitigations and communications with the trustees about the event. Financial penalties apply for failure to comply.

Information gathering

Interview powers are clarified and greater detail is given around TPR's powers of inspection. TPR may issue a fixed penalty notice including escalating penalties for failure to comply with an interview request.

David Fairs of TPR commented that "Enhanced information-gathering powers will significantly aid our investigations by giving us more tools to progress them effectively and efficiently, including by being able to compel people to attend interviews and giving us broader powers to conduct inspections."

Civil financial penalties are also introduced for providing false or misleading information to TPR or to trustees / managers of schemes.

Financial penalties

A new financial penalty regime is set out with a maximum penalty of £1 million. Notice of any penalty must stipulate periods for payment and reasons for its imposition. Relevant dates for recovery of the debt by TPR are clarified.

Pensions Dashboards

The new Act introduces provisions facilitating the introduction of Pensions Dashboards. Guy Opperman has stated that the passing of the 2021 Act will speed up the creation of dashboards and allow required secondary legislation to progress.

A dashboard service is defined as 'an electronic communications service by means of which information about pensions may be requested by, and provided to, an individual or a person authorised by the individual.' Requirements will prescribe what information is to be provided (to include state pensions, additional pensions and information relating to individuals), circumstances in which it is to be provided and how a service is to be established, maintained and operated. Providers will need to be approved, satisfy certain conditions and provide specified information, facilities or services. Providers will also be expected to cooperate and coordinate activities with Money & Pensions Service ("MaPS") and enable MaPS to monitor compliance. Personal data processing should not breach data processing legislation. Regulations are to follow setting out provision, and facilitating provision, of information by schemes by means of a dashboard service with information to be made available including the constitution, administration and finances of the scheme and information relating to benefits. Regulations will follow giving more detailed requirements and compliance

The Pension Schemes Act 2021 (cont.)

arrangements. TPR will have powers to issue compliance and penalty notices.

The Act also includes a requirement for MaPS to provide a dashboard service which may provide information about state pensions, basic and additional retirement pensions and state pension information relating to an individual.

Funding

A separate schedule to the Act covers amendments to Part 3 of the Pensions Act 2004, looking at scheme funding. Trustees will be required to determine and, if needed, revise a strategy (a 'Funding and Investment Strategy') for ensuring that pensions and other benefits can be provided over the longer term. The Strategy must specify the funding level the trustees intend the scheme to have and the investments they intend the scheme to hold on relevant dates. Regulations will follow setting out prescribed matters which may include actuarial methods, the level of detail to be included, the period in which the strategy must be determined and providing for review and revision. Civil penalties apply for failure to comply. The trustees must also prepare a Statement of Strategy as soon as practicable after determining the scheme's Funding and Investment Strategy. This will comprise the Funding and Investment Strategy and supplementary matters (the extent to which the Funding and Investment strategy is being successfully implemented and, where it is not, the steps proposed to remedy the position), the main risks faced in implementation and any reflections on any significant decisions taken in the past which are relevant. Trustees must consult the employer in preparing or revising the supplementary matters.

The Statement of Strategy must be signed by the Chair of the trustees. Again, more regulations are expected to add greater detail. The Act also provides that a scheme's technical provisions shall be calculated in a way which is consistent with the scheme's Funding and Investment Strategy and that trustees must send copies of actuarial valuations and the Statement of Strategy to the Regulator. Regulations will also set out requirements for appropriate recovery plans.

Climate change

Wealth invested in UK private pension schemes is now estimated to be in excess of £6 trillion with many investors having a keen interest in seeing their money invested sustainably. David Fairs of TPR has noted that "trustees are expected to step up and put climate change at the heart of scheme governance".

The Act provides for the issue of regulations (published, (See later article) ensuring trustees implement effective governance of a scheme in respect of the effects of climate change and risks and opportunities arising, including review of exposure of the scheme to risks, assessing assets as to their contribution to climate change and determining, reviewing and revising a strategy for managing the scheme's exposure to risks and targets. Trustees must measure performance against these targets. Trustees will be required to take into account different ways in which the climate might change and different steps that might be taken, adopting prescribed assumptions including steps towards, and achievement of, the Paris Agreement (holding the global average temperature increase to below 2°C above pre-industrial levels). Regulations will require

The Pension Schemes Act 2021 (cont.)

publication of information relating to the effects of climate change, free of charge and in a prescribed form. Regulations will also ensure compliance, giving TPR authority to issue compliance notices and penalty notices.

Transfer values

Further provisions in the Act focus on rights to cash equivalent transfer values. Trustees may be unable to make transfers if certain conditions are not met concerning for example, the member's employment, residence or the member obtaining information or guidance.

CDC

A framework for the development of CDC schemes is set out in the Act. This includes authorisation conditions and requirements for actuarial valuations to be obtained. TPR will authorise schemes, maintain a listing, and require supervisory returns. Significant events will be notifiable though details will follow in Regulations. TPR may also issue risk notices, requiring trustees to submit a resolution plan, where there is an issue of concern or TPR consider that the scheme will breach authorisation criteria. Authorisation may be withdrawn on the occurrence of a triggering event. Once a triggering event occurs, the scheme will need to pursue one of 3 stated continuity options – to wind up, to resolve the triggering event or to convert into a closed scheme. Much of the detail is left to regulation but trustees will need to produce an 'implementation strategy' within a set timeframe if a triggering event occurs setting out how the interests of members are to be protected including information about administration costs, the relevant continuity option and how it will operate.

Conclusions

As already noted much of the detail is to follow in Regulations which may take time to produce. The thinking behind the Act was first developed pre COVID-19 – it remains to be seen whether the current economic conditions impact the Government's timeframe for action.

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

Since March 2020, when the effects of the COVID-19 pandemic first hit the UK, TPR has issued several pieces of guidance. These were few in number initially, and considered the most immediate risks but have evolved to some 14 guidance documents covering a range of impacted topics. COVID-19 has also seen regulatory initiatives cancelled or postponed, relationship supervision affected and some consultations pushed back including consultations, notably on the Single Modular Code and Funding.

Key themes have emerged which recur in various pieces of guidance.

Trustees are encouraged to check that their administrators have contingency plans in place and that they are focusing on the most critical issues – i.e. getting the right money to the right members in good time. Administrators activities should be prioritized, which may mean changes to procedures (such as allowing electronic signatures).

Openness and engagement are encouraged in negotiations between the trustees and employers. Ongoing covenant monitoring is advised during the current period of volatility caused by COVID-19. TPR suggest lines of enquiry for trustees in making their assessment of the strength and quality of the employer covenant.

Ensuring equitable treatment for the scheme is another recurring theme. Trustees may receive requests for contribution delays, reductions or suspensions due to employer cash flow constraints. With the benefit of some months' hindsight, trustees now have better visibility of an employer's position to enable them to ensure the scheme is being treated fairly vis a vis other employer creditors. Trustees should always appraise such requests with a view to acting in the best interests of members – a contribution delay, for example, may be in members' best interests if it allows the sponsoring employer to continue in business – however, TPR have made clear that such provisions should not become an ongoing arrangement. Note that variations may require amendments to be made to a scheme's Schedule of Contributions. Trustees should also consider protections and mitigations where suspensions or reductions are accepted. Similar considerations apply where trustees are asked by the employer to release security.

A period of uncertainty and heightened risks will influence trustees' considerations in a number of areas such as cash flow requirements, investment strategy and diversification, derivative holdings, counterparty exposures, portfolio changes already approved, governance arrangements (ie around investments, risk and committee operating procedures), protection of member benefits and trustees' IRM policy and monitoring.

Scam dangers are also highlighted. Members may make large losses and cease contributions or transfer / sell investments – thus crystalising those losses. Trustees are recommended to review scheme communications to members to outline the impacts of volatility, urge members to seek advice and warn of the danger of scams.

Specific concerns of relevance to DC schemes are noted. If contributions are diverted to funds other than those selected by the member, then a 'default'

TPR: Guidance on COVID-19 (cont.)

fund may have been created. If so, then the scheme will have to ensure relevant compliance requirements are met.

Several regulatory easements were made available in the early COVID-19 period. These have now been removed.

Overall, trustees are encouraged to take advice, obtain relevant information, adhere to the trust deed and rules, make decisions in good faith and document all decision making and conclusions.

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. In relation to historic transfers, trustees may choose to estimate the top up required by applying the percentage uplift for deferred members, calculated following the 2018 judgment, to past volumes of transfers paid from the Scheme with an uplift for interest.

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

GMP equalisation update - historic transfer values (cont.)

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).

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.

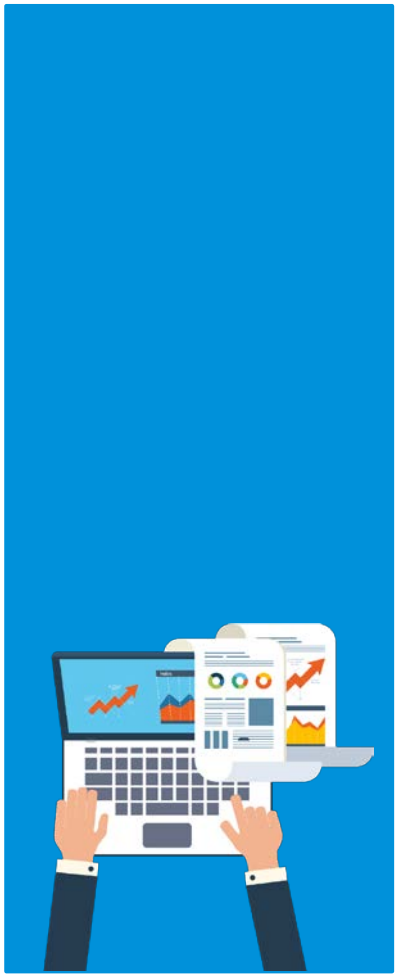
— the Statement of Investment Principles, the Chair's Statement (inclusive of charges and transaction cost information, value for money assessment and default SIP), and the relevant section of the Annual Report (the implementation statement) do not necessarily have to be produced as a single web-page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

Pensions Dashboard project - plans for 2021 and data standards



On 12 January the Pensions Dashboards Programme ("PDP") published a blog summarising their activity in 2020 and setting out what they hope to achieve in 2021. This follows the December release of their data standards guide setting out expectations in relation to the type of data which needs to be verified and made available to facilitate the new dashboard system.

The PDP has grown in size over 2020 and moved beyond initial planning. Research has been undertaken, progress reports and a timeline outlining expected progress towards operation as 'business as usual' published.

The timeline outlines that during 2021, the PDP will undergo a 'develop and test phase' before moving onto voluntary onboarding and ongoing testing from 2022 followed by staged onboarding and a 'Dashboards Available' point in 2023. However it is noted that dashboards will only be made publicly available with 'find' and 'view' functionality when:

— security of the system is assured;

— extensive and robust testing has been undertaken;

— the impact of user behaviour has been understood and any unintended consequences mitigated;

— a regulatory framework is in place; and

— coverage both in terms of pension providers / schemes and information is sufficiently high so as to make dashboards useful to the majority.

The Pensions Act 2021 (see earlier article), provides the legislative framework for compulsory availability of data. The PDP will begin procurement of the necessary digital resources such as the user consent and authorisation and pension finder services and a system for digital identity verification.

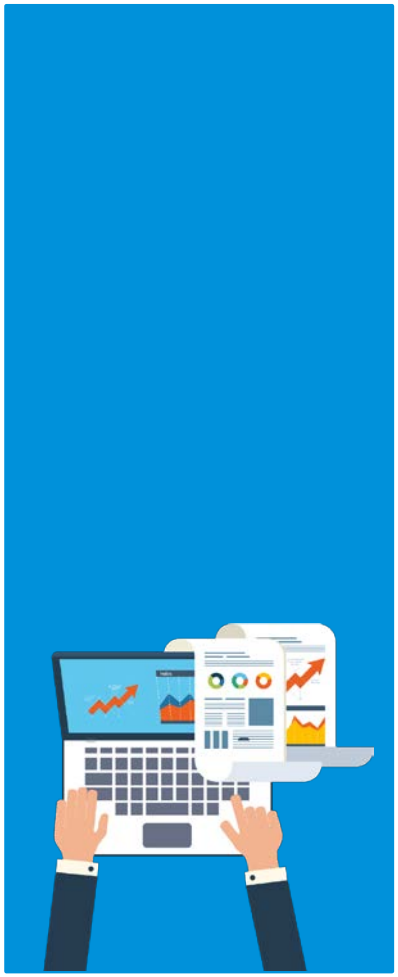
Research will continue with PDP already looking at user needs and expectations. Onboarding strategy will be further developed and detail on staging dates will be available later in the year.

The publication of the PDP's data standards document in December was a significant step. Standards outlined are intended as a starting point and will evolve. It is suggested that a final set of data standards will be made available once the supplier of the digital architecture is in place. The standards are applicable to all pension providers (a term encompassing occupational pension schemes).

It is noted that lack of comparability in the way estimated retirement income ("ERI") is supplied will present issues. PDP suggest that ERI is initially reported in the 'best possible way', although this may not be optimal. A Usabiity Working Group will test responses to varying data presentations. PDP will progress the elements of data used to 'find' pension pots while coming up with a solution to the ERI issue (part of the 'view' data delivery).

The December data standards publication outlines data element definitions (categorized as mandatory, conditional or optional) allowing pension providers to assess their own data for quality and availability. The document includes a process flow chart clearly showing the chain of events leading to the release of data to a member via a dashboard. The steps are outlined as below.

Pensions Dashboard project - plans for 2021 and data standards (cont.)



Request matching pensions (find data)

Verified identity data is passed to pension providers through the pensions finder service. The pension providers then aim to match an individual to their own records using whichever 'matching rules' they deem appropriate.

Return key and request pension information (match data)

If a match is made in stage 1, a coded identifier is returned to the pensions dashboard via the consent and authorisation service. This does not contain any information about the pension or the individual. The identifier is then returned to the pension provider to request the information. After passing through the consent an authorisation service, the pension provider then supplies the information for viewing on the dashboard.

Return view data (view data)

Data is sent to the dashboard to be accessed by the user, which could include scheme, administrator, relevant employment, ERI, accrued pension amount and directions to further information.

Throughout the process, any data not meeting the standards should be discarded.

What trustees need to do

Trustees should seek advice as to next steps appropriate to their scheme. With onboarding commencing from 2023, time is of the essence for pension providers to review their data to ensure that standards are met.

TPR: Defined benefit funding code of practice - consultation

TPR issued an Interim Response to its first Defined Benefit Code of Practice consultation in January. This will be followed by a full summary of responses to be included as part of a second consultation, now scheduled for publication, subsequent to the passage of the Pensions Act and consequent regulations, later in 2021.

TPR received 127 responses (containing over 6,000 comments) to the first consultation, noting overall support for the principles and approach outlined. However some concerns were also raised. These focussed on setting the Fast Track guidelines, the treatment of open schemes (addressed in a recent TPR blog, noting the impact of 'open' status changing), flexibility, evidential burden if choosing the Bespoke route, the perceived quality of the Bespoke route and ability to rely on covenant. The need for schemes to manage liquidity needs (which may not run to plan) is also discussed in their recent blog. TPR will consider comments made in the coming months.

The second consultation is also anticipated to cover the draft code of practice proposed regulatory approach, including thinking on Fast Track reviews, valuation assessments, engagement and enforcement. An impact assessment will also be included.

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.

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

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.

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.

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 Act 2021.

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.

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

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 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.

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

Journey planning and technical provisions

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.

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 the second half of 2021 which will incorporate feedback received in the current document.

Indirect Tax Update: United Biscuits (Pensions Trustees) Ltd & another (C-235/19)

Until the UK law changed last year, Defined Benefit (final salary) ("DB") pension fund management carried out by insurers could be treated as exempt from VAT, whilst DB fund management carried out by non-insurers was subject to VAT at 20%. The reason for the disparity is that pension fund management, when undertaken by an authorised insurer, is a contract of insurance under the Finance Services and Market Act ("FSMA"). As a result of HMRC's change in policy from 1 April 2019, the supply is now taxable irrespective of who carries it out (unless the contract has the hallmarks of insurance). The United Biscuits case relates to the situation prior to change in policy where a number of claims were submitted by taxpayers on grounds that non-insurers had incorrectly charged VAT on their supplies of pension fund management.

It was originally a fiscal neutrality argument on the grounds the service was the same irrespective of who performed it, so should have the same tax liability (i.e. the services provided by non-insures should also have been exempt as the provision of insurance).

The UK Court of Appeal ultimately referred the case to the Court of Justice of the European Union ("CJEU") for determination. The CJEU provided the following answer to the key question put before it.

Are DB fund management services insurance transactions?

The CJEU opined that supplies of DB pension fund management services are not insurance transactions for VAT purposes as the managers do not take on risk in return for a premium, which is what insurance is from a VAT perspective.

The taxpayer asserted that in the English version of the First Life Assurance Directive, the management of group pension funds is described as a class of insurance, and therefore the supplies should be exempt.

In response, the CJEU stated that the Directive refers in the main body of the text to insurance activities and operations that are closely linked to insurance. Management of group pension funds is listed as an operation, not insurance. The CJEU stated that this analysis is not undermined by the English language wording.

In view of the conclusions reached by the CJEU, the management of a group pension fund is not an insurance transaction, as such management of a DB pension scheme is subject to VAT at 20%,

Taxpayers who have submitted claims and have Appeals stood behind the *United Biscuits* case should consider whether these should be withdrawn

Impact on Pension Funds

The outcome of the *United Biscuits* case will be a disappointment for the pension fund industry. VAT incurred on investment expenditure i.e. investment management and investment consultancy fees (where the services relate to the strategy and/or assets of the fund) is treated as belonging to the pension scheme in the first instance, for VAT recovery purposes. As such this will continue to give rise to irrecoverable VAT for pension schemes. Options are available to reduce the level of irrecoverable VAT. Pension schemes should consider whether any of the options below can be used / applied to reduce the level of irrecoverable VAT incurred.

— **Exemption for the management of a DC pension scheme**

The CJEU has determined that the management of a pension scheme with defined contribution characteristics qualifies for exemption. Therefore, if a scheme has a DC section it may be possible to obtain exemption for services that relate to that part but the contractual position will be critical.

Indirect Tax Update: United Biscuits (Pensions Trustees) Ltd & another (C-235/19) (cont.)

— **Apportionment of Investment Related Costs**
VAT incurred on the costs of administering a pension scheme can be recovered by the sponsoring / a participating employer (according to the employer's VAT recovery rate – which is usually higher than the Schemes).

Where VAT is incurred on a service that covers both the investment and administration of a pension scheme e.g. an investment management service that also includes elements of administration of a pension scheme), HMRC allow the VAT to be apportioned on a 70/30 basis i.e. 70% of the VAT is attributed and recovered by the Trustee, and the remaining 30% by the employer).

Often schemes and employers have not sought to apportion these costs, meaning that input tax has not been recovered. It may therefore be possible for employers to seek recovery of VAT.

— **Options available under HMRC's policy changes**

HMRC updated its policies in relation to the recovery of VAT incurred on pension related costs. This presents defined benefit pension schemes with new options to reduce the level of irrecoverable VAT. These are summarised below:

— The use of Tripartitie agreements between the Scheme, the Employer and the investment managers: potentially allowing for all input tax incurred, in respect of both investment and administration costs, to be recovered by the employer;

— The implementation of a service agreement between the Scheme Trustee(s) and the employer: potentially allowing for all input tax on administration and 50% of investment related costs to be recovered by the employer; and

— Adding the Scheme to a UK VAT group with the employer: potentially allowing for all input tax on administration and 50% of investment related costs to be recovered by the employer.

Other news

Changes to the Specified Supplies Order

As of 1 January 2021, businesses are entitled to reclaim input VAT related to the provision of certain financial services products supplied to EU counterparties. Pre 1 January 2021 VAT recovery was restricted to supplies of certain financial products to counterparties belonging outside the EU. This change in policy opens up the possibility for pension schemes to recover more of the VAT they incur on costs. How much additional VAT can be recovered will depend on the nature of the relevant investment portfolio. Pension schemes should review their portfolios to understand what the impact would be.

TCFD recommendations: draft climate change regulations and statutory guidance issued

Introduction

On 27 January 2021 The Department for Work and Pensions ("DWP") issued its response to the "Taking action on climate risk: improving governance and reporting by occupational pension schemes" consultation published in August 2020. The consultation received nearly one hundred responses and a number of amendments have been made to the original proposals which we have covered in previous editions of Round-Up.

Headlines

DWP also published a new consultation on draft regulations that would enact the policy proposals together with new draft statutory guidance.

Schemes with relevant assets* of £5bn or more on the first scheme year end date to fall on or after 1 March 2020 (previously 1 June 2020), must meet the climate change governance requirements for the current scheme year from 1 October 2021 to the end of that scheme year (unless audited accounts have not been obtained in respect of that scheme year, in which case from the date they are obtained.) Trustees must also publish a TCFD report within seven months of the end of the scheme year which is underway on 1 October 2021 (unless scheme relevant assets are zero on the scheme year end date).

*Relevant assets are (except in the case of earmarked schemes) net assets of the scheme, excluding bulk and individual annuity policies.

If on or after 1 October 2021 the scheme is an authorised master trust or a collective money purchase scheme, then trustees must meet the climate change governance requirements for the current scheme year which is underway to the end of that scheme year and produce a TCFD report within seven months of the end of the scheme year which is underway.

The trustees must include a link to the TCFD report in the annual report and accounts produced for that scheme year.

Schemes with £1bn or more assets have an additional twelve months to comply.

The Climate Change Regulations

Governance

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

Trustees must establish and maintain processes for the purpose of satisfying themselves that:

— any person who undertakes governance activities in relation to the scheme otherwise than as a trustee, takes adequate steps to identify, assess and manage climate-related risks and opportunities which are relevant to the scheme; and

— any person who is not a legal adviser of the trustees and who advises or assists the trustees with respect to governance activities, takes adequate steps to identify and assess climate-related risks and opportunities which are relevant to the matters in respect of which they are advising or assisting.

TCFD recommendations: draft climate change regulations and statutory guidance issued (cont.)

Strategy and scenario analysis

Trustees must, on an ongoing basis, identify and assess climate-related risks and opportunities which they consider will have an effect over the short term, medium term and long term on the scheme's investment strategy and the funding strategy (the latter where applicable).

The time periods short, medium and long term are as the trustees determine are appropriate taking into account the scheme's liabilities and its obligations to pay benefits.

Trustees must, as far as they are able, undertake scenario analysis in at least two scenarios where there is an increase in the global average temperature and in one of those scenarios the global average temperature increase selected by the trustees must be within the range of 1.5 and 2 degrees Celsius above pre-industrial levels.

The scenario analysis must be undertaken in the first scheme year and then every three years thereafter. In any scheme year where the trustees are not required to undertake scenario analysis, the trustees must review the most recent scenario analysis they have undertaken and determine whether it is still appropriate.

Where the trustees have determined that it is appropriate to undertake new scenario analysis, they must do so as far as they are able.

Note, schemes with DB and DC sections will need to do separate scenario analysis.

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. Trustees must also ensure that management of climate-related risks is integrated into their overall risk management of the scheme.

Metrics and targets

Trustees must select 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 climate change metric.

Trustees must on an annual basis and as far as they are able, obtain the data to calculate their selected absolute emissions metric, emissions intensity metric and their additional climate change metric, and use the metrics they have calculated to identify and assess the climate-related risks and opportunities which are relevant to the scheme. This metric selection must be reviewed from time to time as appropriate for the scheme.

Trustees must set a target for the scheme in relation to at least one of the metrics which they have selected to calculate and on an annual basis measure, as far as they are able, the performance of the scheme against that target. Trustees must then determine whether the target should be retained or replaced depending on scheme performance.

TCFD recommendations: climate change regulations and guidance (cont.)

"As far as they are able"

"As far as they are able" is defined as trustees taking 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 by the trustees, or any person to whom the trustees have delegated responsibility,

TKU requirements

The DWP have added to the governance proposals the requirement for trustees to have an appropriate level of knowledge and understanding of the principles relating to the identification, assessment and management of climate change risks and opportunities to enable them to properly exercise their duties. The DWP add that trustees are not required to be experts, but have sufficient expertise so that they properly exercise governance over climate change risks and opportunities.

Disclosure requirements

Trustees are required to publish their TCFD report on a publicly available website, free of charge. The chair of trustees must also sign the report. In addition, a link to the report must be included in the Annual Report and Accounts (accompanied by a short summary if trustees wish to do so). Members must be notified of the report either in their annual benefit statements, or via the scheme funding statement depending on the scheme.

Trustees must provide the web address where the TCFD is published to TPR, together with the website location for the Statement of Investment Principles, Implementation Statement and excerpts from the Annual Chair's Statement in the annual scheme return form.

The DWP have added a requirement for trustees who have not yet produced their first TCFD report to inform TPR whether the period for doing so has ended.

Audit implications

At this point, there is no specific requirement for the TCFD report to be audited, but as there would be reference to it in the scheme Annual Report and Accounts, the auditor would need to fulfil its responsibilities under ISA (UK) 720 on "Other information" – similar to the Annual Chair's Statement and the Implementation Statement.

TCFD recommendations: climate change regulations and guidance (cont.)

Review

Originally planned for 2024, the review of the requirements for smaller schemes will now take place in the second half of 2023.

Penalties

TPR will be able to issue discretionary penalties for inadequate reports, but a mandatory penalty will only be issued for the non-production of a report.

Failure to notify members via their annual benefit statements or to include a link to the TCFD report from the Annual Report would be subject to the existing penalty regime set out in the Disclosure Regulations i.e. up to £5,000 for an individual trustee and £50,000 for a corporate trustee.

Concluding comments

The Consultation period closes on 10 March 2021.

All pension schemes are exposed to climate-related risks and opportunities and sponsoring employers face the same challenges.

Although data sources and best practice will evolve over time, trustees must educate themselves now on the TCFD recommendations and what it means for their scheme. There is much information and guidance already available, now including the Pensions Climate Risk Industry Group's non-statutory guidance which was finalised at the same time the Government published its response and draft regulations and statutory guidance in January.

In a recent press release following TPR's annual survey of DC schemes, the Regulator reported that not enough attention is being paid to climate change risks and opportunities by DC trustees and managers: an alarming 21% of those surveyed felt that climate change was not relevant. David Fairs, TPR's Executive Director of Regulatory Policy, Analysis and Advice confirmed that in the Spring, TPR will publish a strategy setting out how the Regulator will help trustees meet the challenges around climate change.

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.

We will be developing further guidance on the TCFD recommendations to assist trustees navigate around the new regulations. We will keep you updated in our next edition of Regulatory Round-Up.

Implementation statements and other related 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.

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.

So far, content of the statements has varied and a number of schemes have stated that they had difficulties obtaining data on voting activity. Back in November 2020, the Association of Member-Nominated Trustees published a report "Bringing shareholder voting into the 21st century" which highlighted challenges faced by trustees when seeking to exercise their rights to vote in line with their own voting policies. This was particularly evident when the scheme had pooled fund arrangements. The report made certain recommendations which included improvement to the voting infrastructure, more investment in the stewardship function in fund management and improvement to the transparency of voting policies and outcomes.

Following this report, the Pensions Minister set up the Task Force on Pension Scheme Voting Implementation to address these barriers faced by trustees. The Minister has also announced that a central directory of Statements of Investment Principles is to be set up and supported by both the DWP and TPR.

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.

Small Pots Working Group Report

The Small Pots Working Group, set up to consider issues surrounding the existence and consolidation of small deferred pension pots, published a report In December outlining their findings and conclusions. The Group was set up by Guy Opperman to inform the approach to small pot consolidation while protecting members and controlling charges.

Their findings highlighted the large numbers of small pensions savings pots. It is suggested that the average number of jobs a person might have in their lifetime is in excess of ten. If each of these provides a pension pot (as is required under auto-enrolment legislation), many inefficient small pots will result which may be susceptible to loss through members losing track of them and erosion due to charges. They will not necessarily provide their owners with an incentive to save towards good quality pension provision (damaging the reputation of auto-enrolment policy) and pension providers could suffer if the management of such pots is uneconomical. There are currently estimated to be 8 million deferred pension pots held in Master Trusts with an average value of approx. £1,000. Data collected by the DWP over large DC schemes suggests that three quarters of deferred pots are smaller than £1,000, and a quarter smaller than £100, giving an idea of the scale of the problem. However, the Working Group notes that more analysis is needed. Even smaller 'micro' pots typically resulting from employment changes and in the range £25 to £250 are discussed but no proposals are made in this area.

Some current policy initiatives are already working to alleviate the issue, i.e. proposals for a minimum pot size before flat charges can be made, enhanced pensions planning made available through the advent of Pensions Dashboards and the simplification of benefit statements to improve member understanding.

Consolidation may make the market more efficient and achieve better member outcomes. Fewer pots would result in reduction of charges and administration effort. The report suggests that consolidation should comprise a mix of member-initiated and automatic solutions (such as default small pot consolidation and automatic pot follow member models).

Recommendations

The Working Group suggest that member- initiated solutions should continue to be explored and may be effective if members are engaged with their savings. This fits in with developments in technology, such as dashboards. However, there is also a need for automatic and automated consolidation solutions.

Solutions recommended are:

— Same provider / scheme consolidation of multiple pots for the same member or, as an initial step, a single consumer facing view of pots held.

— Member exchange should be a concept trialed as part of the investigation into administration challenges to be overcome in delivering mass transfer and consolidation systems. Such trials, which should involve a range of stakeholders, would allow investigation of matching capability (to verify identification), data standards, costs, member experiences and safeguards.

Small Pots Working Group Report (cont.)

— The report also recommends cost / benefit analysis of consolidation models such as default small pot consolidation and automatic pot follow member models, together with 'customer journey mapping' to understand the full impacts.

The report notes that work should be done on administration systems to reduce friction and facilitate large scale consolidation, highlighting the minimum necessary processes. Some progress is being made with the development of data standards by the Pensions Dashboards Programme (See earlier article) which can then be developed further for use in consolidation. Identify verification is critical; the industry will need to define data fields necessary to provide safeguarded matching capability to ensure the correct recipients of pension pots being transferred, even without member consent. Low-cost bulk transfer processes will need investigating, looking first at the current processes though recognising that automated transfers may require new approaches. Appropriate governance arrangements will need to be considered.

A move towards consolidation will require the investigation and addressing of administrative challenges, to facilitate low-cost mass transfers within the auto-enrollment market. The results, together with assessment of the impact on members, will then inform decisions on larger scale solutions: the report presents a roadmap towards achieving this. Analysis of any need for new legal powers may also be necessary.

As Guy Opperman notes in the Ministerial Foreword, more work is still required to overcome administrative challenges involved however recent industry comment indicates that the rewards could be significant.

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

Costs and charges

On 13 January 2021 the DWP published its response to the Review of the Default Fund Charge Cap and Standardised Cost Disclosure. The charge cap was introduced in 2015 and the review on 2017 confirmed it had helped to drive down costs for members.

The paper confirmed that following the 2020 Pensions Charges Survey, the charge cap of 0.75% remains the right level and so no change will be made at the present time. The Government also confirmed that transaction costs would not be included within the charge cap at present.

An additional concern amongst those that responded to the review was the issue of members with small pots, particularly deferred pots and value can be eroded when charges are applied, principally where a flat fee is used. In response, the Government have now set a de minimis pot size of £100 on each member for default funds of schemes used for auto-enrolment. Note however percentage charges applicable as part of a combination charge could still be charged.

The final key area on the review covers the reporting of costs and charges. The responses received indicated a support for the standardised Cost Transparency Initiative ("CTI") templates and although the Government confirmed it will not at present legislate to ensure take-up, if voluntary use is not sufficient, then this could change.

Auto-enrolment trigger and thresholds: 2021/2022

The Government has announced that for 2021/22:

— the auto-enrolment earnings trigger will remain at £10,000; and

— the lower limit of the qualifying earnings band will remain at £6,240, and the upper limit of the qualifying earnings band will increase to £50,270 (from £50,000).

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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