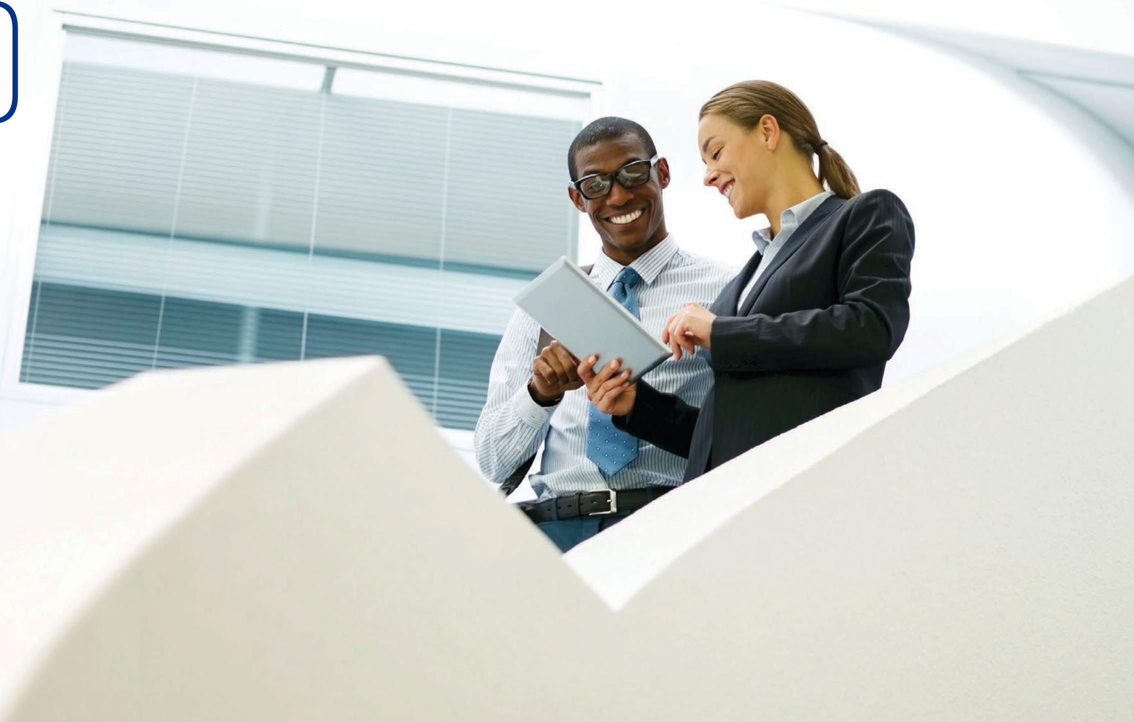
Pensions accounting, assurance and regulatory round-up



Private sector occupational pension schemes

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June 2021

Introduction

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 Pensions Regulator ("TPR"), the Department for Work and Pensions ("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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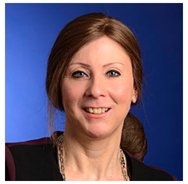

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Contents **Page**

TPR

TPR: The new code of practice

On 17 March 2021 TPR released their consultation on a new code of practice. The new code which is designed to re-present the content of the codes it replaces, takes account of changes introduced by the Occupational Pension Schemes (Governance) (Amendment) Regulations 2018 (the 'governance' regs) aiming to improve standards of governance.

David Fairs, TPR, said: "The new code of practice represents TPR's ambition to create a single point of consistent and up-to-date information for all pension scheme governing bodies."

Initially the new code will replace 10 existing codes but will be broadened out to include additional current codes and guidance over time. The objective of the new code is to update any current code of practice which is out of date, to avoid duplications, to improve consistency and to make the material easier to access, more navigable and more understandable. Expectations are set at the level of a well-run scheme and should be already being met (other than where the expectation is new, such as the Own Risk Assessment ("ORA")). The new code has a very different 'look and feel' about it. The material is presented as a series of short modules (some 51 of them) each focusing on a distinct topic area and halving the number of pages as compared to those codes it is replacing. An overhaul of the website is also planned. The new presentation of TPR codes and guidance will take time and the new code will evolve as the project progresses. The new presentation should make update much easier and a planned update cycle is proposed. It is noted that the current draft does not contain any provisions arising from the Pension Schemes Act 2021; this will be introduced in future updates. Each module comprises between 1 and 5 pages, the content being much less narrative and more prescriptive (including lists setting out TPR's expectations) than has been the case in drafting codes of practice to date. The consultation notes however, that lists should not encourage a 'tick box' approach to compliance, but rather prompt discussion and consideration of whether the required standards are being met. The new code uses terminology to clarify the requirements: legal duties referred to as 'must', TPR expectations as 'should' and necessary processes as 'need'.

The proposed new code also introduces the term 'governing body' as a simplification to refer to trustees and managers of occupational schemes, managers of personal pension schemes and managers / boards of public service schemes. Each module aims to make clear who it applies to and this is supported by a table of modules and their application appended to the consultation document.

The governance regs introduced new requirements for pension schemes. Three key areas are highlighted in the new code. These are, in outline, the need for:

- An effective system of governance ("ESOG") – the code includes a module signposting areas describing what a minimum effective system of governance should look like. The module highlights a proportionate approach and provision for regular (at least at 3 yearly) internal review.
- Internal controls – the need for internal controls to support effective systems of governance is reiterated. Governing bodies need to put robust and measurable internal controls in place to manage risk and be assured that the scheme is operating as intended. The design of internal controls will be for each governing body to determine as relevant for their scheme. The new code sets out a range of modules looking at differing areas of risk management including identifying and assessing risks, managing risk and assurance.
- An ORA, which is required for all schemes with over 100 members, is a process for assessing the management of all risks which the scheme faces. An ORA must be completed within 12 months of the new code becoming effective and will then need to be reperformed annually. The requirement is scaleable to scheme size and complexity and must be documented, though there is no requirement for submission to TPR.

Mastertrusts are not covered by the new code in this phase and should continue to refer to Code of Practice 15.

The code includes modules on stewardship (encouraging an active role) and managing risks around climate change. The consultation also notes the importance of.

TPR

TPR: The new code of practice (cont.)

cyber controls with governing bodies urged to reduce the risk of incidents and manage those which do occur

The Consultation, which includes a number of consultation questions applying both to all and selected specific modules, closed on 26 May 2021.

TPR

TPR: Climate Change Strategy

On 7 April 2021, TPR published its Climate Change Strategy, setting out its strategic response to climate change and how it can help trustees meet the challenges from climate change.

The plan aligns with the previously published Corporate Strategy and sets out a number of aims and objectives driven by the Government's Green Finance Strategy, the new regulations set out in the Pension Schemes Act 2021 and the target to get to net zero by 2050.

Aims

— Create better outcomes in later life for workplace savers by driving trustee action on the risks and opportunities from climate change.

— Seek to influence debates around pensions and climate change.

— As a business, take part in the transition to net zero.

Aim: Create better outcomes in later life for workplace savers by driving trustee action on the risks and opportunities from climate change

Trustees face a number of climate change regulatory requirements and reporting duties. TPR's role is to regulate and enforce where necessary.

Objective 1: TPR want to see schemes publish their SIP, implementation statement and, for those in scope, disclose their TCFD report. Where they do not, and it is appropriate to do so, TPR will take enforcement action, which may be publicised.

Objective 2: TPR will publish guidance later this year outlining its approach to the new TCFD regulations. As with SIPs and implementation statements, the Regulator may take enforcement action against those not meeting legal duties.

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Aim: TPR will influence debates around pensions and climate change

TPR will continue to work with the Government and key stakeholders, together with other financial regulators to influence the debate around climate change.

Objective 3:TPR will use its communications tools to promote this strategy, call on its regulated community to meet expectations, and be clear about the steps it has taken to contribute to climate goals as a business and enhance its credibility.

Objective 4: TPR will work with government, key stakeholders and other financial regulators, participating in groups on climate change and stewardship to influence debate, align plans where relevant, and sharing insights.

Aim: TPR will, as a business, take part in the transition to net zero

TPR will take responsibility for the climate impact of TPR as a business. This means reducing its own environmental impact, managing climate risks and adapting to new conditions.

Objective 5: Before the UN COP26, TPR will publish a Climate Adaptation Report which will include an outline of its plans towards using the TCFD recommendations, where applicable, as a framework for its own management of climate risk.

Objective 6: TPR will set itself a 2030 net zero carbon emissions target and by 2024 set out its plans to achieve this.

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TPR

TPR: Climate Change Strategy (cont.)

The regulatory approach

— Setting clear expectations

TPR will publish guidance on the new regulations outlined in the new Pension Schemes Act 2021, share best practice TCFD and for defined benefit schemes set out how to take account of the impact of climate change in Integrated Risk Management (IRM). TPR will also set out a 'climate risk management plan' requirement for superfunds.

The draft Single Code of Practice sets out modules covering climate change and stewardship to outline expectations of trustees and to support the development of trustees' knowledge and understanding the Trustee Toolkit will be updated for climate change content.

— Identifying risk early

To help identify the extent of risk from climate change, TPR will examine scheme reports on scenario analysis in more detail by carrying out a thematic review on scheme resilience to climate-related scenarios and publish findings.

TPR stress the importance of stewardship and will review a selection of implementation statements, again publishing the findings. TPR also encourage trustees to sign up to the 2020 UK Stewardship Code.

— Driving compliance through supervision and enforcement

To help identify instances of non-compliance with disclosure obligations, TPR will implement new regulations by adding questions to the scheme return, requesting the web addresses for climate change-related documents and also publish on its website an index of the web addresses of scheme SIPs.

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— Working with others

TPR will continue to meet with other financial regulators to develop consistency in its work on climate-related risks and opportunities, and stewardship practice and will include climate change in its dialogue with stakeholders through panels, events and other formal and informal discussions.

— Influencing the debate

With effective communications, including campaigns, guidance, speeches and stakeholder engagement, TPR will be clear about its expectations on climate change.

In Autumn 2021, TPR plans to publish its Climate Adaptation Report, which will outline findings on how those running pension schemes are responding to and managing the risks and opportunities from climate change. TPR will also ask about climate change in its Perceptions Tracker survey.

— Taking part in the transition

The Regulator will develop and improve its own behaviour as an organisation in relation to climate change.

The Climate Change Strategy has been generally well received by the pensions industry, particularly adding climate change to the Trustee Toolkit, and the clarity on what is expected from scheme trustees.

TPR

TPR: Annual Funding Statement 2021

On 26 May TPR published their Annual Funding Statement for 2021 Providing guidance for schemes having valuations between 22 Sept 2020 and 21 Sept 2021 (Tranche 16 valuations).

Analysis shows that over the three years to Dec 2020, funding levels remained broadly unchanged but improvement has been seen in the three years to March 2021, although the position for individual schemes will vary. Trustees will need to assess whether they are ahead or behind their targets and remain focussed on their journey towards longer term targets.

The statement includes guidance and regulatory expectations on the approach to valuations and sets out what TPR expects of trustees and employers and what they, in turn, can expect from TPR. It also includes an update on recent issues. The new DB funding code is not expected to come into force until late 2022. The second consultation on the new code will be published after the regulations flowing from the Pension Schemes Act 2021.

Within the statement, consideration is given to:

1 Actuarial assumptions and scheme demographics

Trustees need to understand the assumptions used in modelling and consider a range of outcomes, the key variables and the sensitivity of the results. Scenario analysis aligned to that of the sponsoring employer is encouraged with trustees having an awareness of the impact of change not only on scheme investments but also on the employer covenant and potentially mortality.

Inflation

Forthcoming changes in the way inflation is measured (alignment to CPIH) from 2030 may mean that assumptions need to be adjusted.

Mortality

COVID -19 may have had an immediate impact on mortality but this is believed to be generally low. There may also be longer term effects from long COVID and the effect of the pandemic on non-COVID healthcare. However, a positive effect on mortality may be seen due to vaccine development and improved lifestyle choices. Scenario analysis may be helpful in understanding the position. Trustees will need to decide whether to retain current mortality assumptions or update them with justifications. TPR state that ‘trustees should ensure their mortality assumptions are balanced, evidence-based and derived using a sound methodology’.

Post valuation experience

Trustees may take experience, either positive or negative, between the effective date of the valuation and the date of its signing into account in finalising recovery plans but must use justifiable assumptions and ensure that the recovery plan is appropriate and in the best interests of members. In allowing for post valuation experience, trustees should take a consistent approach at each valuation done. TPR note that their expectation would be for favourable post-valuation events to lead to reduced recovery plan lengths rather than reduced employer contributions.

2 Investment considerations

Liquidity

In a maturing market, trustees need to monitor liquidity. TPR advocate a proportionate approach including stress testing, exposure to margin/collateral calls through derivatives and assessment of assumptions relevant to high stress scenarios regarding liquidity and asset valuation.

Cessation of banking benchmark for cash-like investments

Referencing discount rates, the statement notes the phasing out of LIBOR and EURIBOR rates.

TPR

TPR: Annual Funding Statement 2021 (cont.)

3 Covenant considerations

Regarding covenant the Statement notes that 'short-term covenant visibility may have improved, but trustees must continue to be alert to the risks of weakening employer covenants and remain engaged with employers as uncertainties continue'.

The statement recognises that the impact of the experience of COVID-19 has been varied with the sector of the sponsoring employers business being a contributing factor. Trustees are urged to seek specialist covenant advice where, amongst other things, the assessment is complex or the scheme is heavily reliant on the covenant. Trustees should be conversant with TPRs guidance 'protecting schemes from sponsoring employer distress'.

Trustees approach to valuations will vary depending on the sponsoring employers COVID experience, which could range from little or no impact to a lasting effect resulting in uncertain future prospects. Stress testing, potentially looking at scenarios considered by the employer, is suggested, particularly in those situations where the future is less clear where trustees will need to determine the potential for significant deterioration in the covenant. Employers should be prepared to share financial projections and business plans with trustees to enable decision making. Trustees should, at a minimum, understand key variables and factors influencing the forecasts. In a situation where COVID-19 has an ongoing effect on the employer, trustees should not assume that the covenant will return to normal without justification. In framing recovery plans, trustees will need to balance sustainability of the employer with fair treatment to the scheme, for example by the employer pausing dividend payments. This is a theme we see coming though from guidance issued by TPR in the immediate aftermath of the COVID pandemic.

Brexit may also have impacted the covenant and trustees will need to factor changes into their considerations.

Conclusions from the above considerations will influence the recovery plan. TPR expects that, where the employer cashflow position allows, recovery plan lengths should be shortened. Any requests from the employer to reduce or defer contributions in the short term should be considered with care and offset by higher contributions at a later date rather than by extension of the recovery plan. Ongoing dividend distribution would be inconsistent with such a request, with repayment of deferred deficit contributions taking priority. Trustees should consider seeking mitigation for reduced or deferred deficit recovery contributions. Such mitigations could include suspension of distributions, contributions made dependent on certain triggers related to employer performance, putting contingent assets in place and ensuring that any support offered to other group companies is in the best interests of the scheme. Trustees need to be aware of any covenant leakage, seeking mitigations where deemed necessary.

TPR encourage frequent covenant monitoring with key indicators tracked, including developments in the wider group of a sponsoring employer. Suitable contingency plans should be made in conjunction with the employer so that they are ready for implementation should the need arise. TPR may seek evidence to demonstrate that liaison with the employer has taken place.

The need for vigilance extends to assessment of the impact of any employer corporate transactions, again trustees should be ready to react and seek mitigations and to ensure fair treatment of the scheme. Trustees should be made fully aware of such proposals and maintain an audit trail of their considerations in such situations which TPR may ask to see evidence of. Should a valuation be ongoing at the same time as a corporate transaction, this will be factored into the valuation but separate mitigation should be sought.

The statement refers to new and complex rules and procedures for distressed companies (indicating PPF guidance) and suggests that specialist advice is sought where relevant.

TPR

TPR: Annual Funding Statement 2021 (cont.)

Managing risks

The importance of integrated risk management (IRM) covering employer covenant, investment risk and funding plans and providing key information is reiterated. The Statement adds that climate change impacts on IRM should be considered, with assessment, mitigation and monitoring of climate risk critical to good outcomes. Climate change may impact on employer covenant, investment strategy and actuarial assumptions. TPRs climate change strategy is also mentioned noting that TPR expects all schemes to publish SIPs and Implementation Statements; TPR will use these documents to monitor how trustees identify and manage climate change risk.

The Statement goes on to discuss how setting a clear strategy for achievement of a long-term goal within an evolving IRM framework is beneficial in meeting the key objective of paying promised benefits. The trustees and the employer set a long-term funding target ("LTFT") targeting reduced dependency on the employer at maturity and high resilience to risk. A journey plan leads to the LTFT, with short-term investment and funding strategies also aligned and any departure from the target managed. This is a fundamental principle from TPR's proposed new Funding Code. The setting of a long-term strategy to achieve a long-term objective will become a legal requirement under the Pension Schemes Act 2021.

Scheme maturity will also need to be factored in, balancing assets and the level of underfunding with the scheme's ability to close any funding gap. As schemes become more mature, employers will need to fund the scheme to ensure these risk are adequately managed. The need for an Own Risk Assessment (ORA) for schemes builds on IRM as it requires consideration of the management of risks. An early start on documenting key risks and how they are managed is advocated as schemes will need to complete their first ORA within the next 3 year valuation cycle.

The Regulator's approach is outlined. It will engage with schemes where corporate stress is identified to ensure that regulatory guidance is being followed, risk assess valuations (trustees will need to be prepared to justify and evidence the approach taken) and may also investigate or intervene in a valuation where no agreement has been reached or the assumptions or recovery plan fall short of required standards, potentially using new powers granted in the Pension Schemes Act 2021. TPR's expectations are set out in tables stratified by funding strength, covenant and scheme maturity. Key risks and funding plan features are noted. Trustees should consider whether their covenant has been impacted by COVID-19 or Brexit, how mature they are and what their funding position is. This will enable them to identify the most appropriate table setting out TPR expectations and suggestions for preparing recovery plans.

DC update

Consultations and responses to consultations have continued to flow throughout the month and June 2021 has seen a number of changes proposed for the defined contribution (DC) market.

Barriers to DC consolidation

On 21 June 2021, the DWP published a call for evidence on barriers to consolidation of defined contribution (DC) schemes: " Future of the defined contribution market: the case for greater consolidation". It follows the September 2020 consultation "Improving outcomes for members of defined contribution schemes," because the Government wants to understand the barriers which are preventing consolidation moving at a faster rate.

The Government believes that there are still too many DC schemes, despite numbers falling between 8-10% each year, and wants to accelerate the pace of scheme consolidation by understanding what barriers DC trustees face, for example, costs, unwillingness of potential receiving schemes to accept "low value" members and charging structures. The September 2020 consultation included the introduction of a more detailed value for members assessment for schemes below £100 million to be reported to the Regulator and disclosed in the annual chair's statement. This aimed at improving governance, serving members better and incentivising consolidation.

The Government is also looking ahead to the consolidation of schemes with asset levels between £100m and £5billion.

The call for evidence runs to 30 July 2021.

Improving outcomes for members of defined contribution pension schemes.

The Government also published its response to the September 2020 proposals on reporting net returns and the new value for members' assessment. The original proposals included:

- Trustees of all 'relevant schemes' regardless of size, would be required to state in the chair's statement the net investment (performance) returns for their default(s) and self-selected funds.
- Trustees of DC schemes with total assets of less than £100 million and that have been operating for at least three years will be required to assess key elements of the value achieved by their scheme on behalf of members.
- Trustees will need to report on the outcome of the value for member assessment in their annual chair's statement and to the Pensions Regulator via the next scheme return. This includes outlining next steps, where trustees conclude that their scheme does not provide good value for members, either immediate improvement or consolidation/wind-up.
- Schemes with assets of £100million or more to continue to comply with the current requirements for assessing value for members by reviewing the extent to which member-borne costs and charges represent good value for members, although they will be able to choose to voluntarily adopt the new form of assessment.

Following responses received from stakeholders, the Government have made a few changes to the regulations:

- The implementation date for the application of the value for member assessment has been pushed back from October 2021, to the end of the year. This means the first value for member assessment will apply for schemes for their first year ending after 31 December 2021.

DC update (cont.)

— The Government have clarified the position on hybrid schemes. A hybrid scheme where the total assets (DC and DB together) are below £100 million are in scope and that it is only the DC element of the scheme that will be subject to the assessment.
— The Government have included in the revised Statutory Guidance a reminder that TPR may be of help on comparator vehicles as they hold a list of authorised master trusts.
— While still requiring that schemes choose larger schemes that are potential consolidators, the requirement that there must be "reasonable grounds" to believe that at least one of the larger schemes would accept a transfer in of the smaller schemes members to that at least one of the larger schemes chosen must 'have had discussions' with the smaller scheme over a potential transfer.
— Introduced in the regulations is now a exemption in the regulations so that smaller schemes that would ordinarily have been in scope will be exempt if they have informed TPR at any time before the next chair statement is due that they are in the process of wind up.

As part of the consultation, the Government had proposed updates to the Statutory Guidance covering costs and charges disclosure and illustrations, having received queries on the production and presentation of these regulatory requirements. The original proposals included:

Production of an illustration:

— a distinction between schemes with a single price for scheme members of all employers, and schemes with multiple defaults and variable charges;

— as a minimum, trustees need to identify the default arrangement(s), lowest charging and highest charging self-select funds in which members are invested;

— where charging levels or defaults vary by employer, each part of the scheme with a different default or charging level should be treated as a separate scheme; and

— where schemes have multiple defaults or variable charges, the savings pot size used should be a median across the whole scheme, rather than producing a median for each default, or for each employer.

Publication of costs, charges and other information:

— to make clear that **all the information** can be published over a number of linked documents or pages; and

— a diagram with supporting notes, to provide a visual representation of how documents can be produced as a series of interlinked documents which is compliant with regulation 29A of the Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013.

Following feedback received, the Government have responded with the following amendments to the Statutory Guidance:

The production of illustrations:

— Use of the median pot size could be used by trustees and managers along with the consideration of other determining factors (particularly for younger scheme members)

— Easement to illustrate self-select funds at scheme level

— Clarity around the types of defaults to be considered

— The treatment of Retirement Date Funds (RDF) and pooled funds

— Alignment with FCA information

— Removal of the requirement to consider decumulation aspects.

DC update (cont.)

The publication of costs, charges and other information

— Figure 3. and the supporting narrative around presenting and publishing information
— The new requirements for net returns and the value for members assessment
— The removal of the need for trustees and managers to publish signed versions of scheme documents (to avoid fraudulent use of signatures).

Default Statements of Investment Principles (SIPs), reporting costs and charges of funds no longer offered and wholly-insured schemes

Default SIPs

The consultation proposed that where the default arrangement includes a promise, the trustees of the scheme should be required to produce a default SIP and that this should be produced within 3 months of the end of the first scheme year to end after the coming into force of these regulations.

The response has now confirmed that the regulations will be amended to give trustees more time. Regulation 4(2) and (3) of the Investment Regulations is amended so that such schemes must produce a default SIP from 1 October 2021, or after the end of six months beginning with the day on which these Regulations come into force, whichever is later.

Reporting of costs and charges of funds which are no longer offered

Regulations stated that costs and charges should be disclosed for any fund which members are or were able to select and in which assets relating to members are invested i.e. for any funds that members would have been able to select in the past in any year, not just during the scheme year. To clarify policy intent, the Government has made a further amendment to the scope of member coverage to the definition of “default arrangement”, as used in regulation 23(1)(c)(i) of the Administration Regulations to cover arrangements where contributions ceased before 6 April 2015.

If, prior to 6 April 2015, all funds were in practice capable of being selected, then such a fund could alternatively be covered by regulation 23(1)(c)(ii). This means that all arrangements are covered by regulation 23(1)(c).

A fund “in which assets relating to members are invested during the scheme year” (reg 23(1)(c)(ii) of the Administration Regulations) is intended to cover a fund which holds assets during the scheme year, rather than a fund to which assets have been added during the scheme year. Deferred member benefits are therefore subject to the requirements of the regulations in this regard.

Wholly-insured schemes

The regulations related to implementation statements contained within the Disclosure
Regulations, include the requirement for trustees to lay out the degree to which the policies that are required to be set out have been put into place with asset managers. Agreeing that a logical cross reference had been omitted in the original regulations, as wholly-insured schemes are exempt from having such policies the Government has now amended the regulations to exempt them from the requirement to disclose how these policies are followed.

Performance fees

In the consultation ‘Incorporating performance fees within the charge cap’, the Government proposed amendments to Regulations 7 and 8 of the Occupational Pensions Scheme (Charges and Governance) Regulations 2015 to allow defined contribution pension schemes to smooth performance fees over a five-year period.

The reason behind this proposal is to remove an identified barrier to investing in illiquid asset classes that generate performance fees. allowing schemes to accommodate the ‘ebb and flow’ sometimes associated with the performance of these assets and still remain within the charge cap. Amendments were to come into force from 1 October 2021.

DC update (cont.)

There was an "almost unanimous" support for the proposals and the Government therefore proceeded with the amended regulations.

The consultation also included a call for evidence on look-through costs, but because of feedback from stakeholders on the administrative complexities involved, this has been put on hold until later in the year when the Government will revise its position.

New Statutory Guidance

Finally, the DWP has published Statutory Guidance for trustees of relevant schemes on completing the annual value for members assessment and reporting of net investment returns.

At the same time, the DWP has published updated guidance on reporting costs, charges and other information on disclosure and administration regulations.

The two sets of guidance are effective from 1 October 2021.

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 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 the 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. On 11 March, TPR published a draft policy for consultation (which closed on 22 April) on how it will use these new powers. The policy is intended to evolve as case law clarifies the primary legislation.

Click here for more info on the draft policy.

However, any indications TPR may give will only be in the form of guidance and will not have the authority of legislation. TPRs draft policy highlights that there is no clearance process for the new offences as exists for Contribution Notices.

The Pension Schemes Act 2021 (cont.)

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."

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 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

Legislation

The Pension Schemes Act 2021 (cont.)

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 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 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.

Legislation

The Pension Schemes Act 2021: draft policy for consultation

TPR's draft policy acknowledges that the introduction of the new offences was not intended to change commercial behaviour, but to give TPR additional powers to deal with more serious intentional or reckless conduct. TPR do not expect to fundamentally change the activity they investigate but will have new powers in dealing with those cases. The new powers will be used to further TPR's statutory objectives, to protect savers and as a deterrent in cases of serious poor behaviour. Criminal liability extends to anyone who helps and encourages another in committing the offence, unless they have reasonable excuse (which is likely to apply to professionals acting in accordance with their professional duty). TPR's draft policy gives a series of examples illustrating behaviours which can expect to be prosecuted.

The statutory exception of reasonable excuse is also discussed. TPR will expect those investigated to highlight any evidence supporting a reasonable excuse and recognise that this will be fact-specific. There are three factors to be taken into account, i) whether the detrimental impact was incidental to the main purpose of the action, ii) whether adequate and fair mitigation was provided and iii) whether there was a viable alternative which could have lessened the impact. Illustrative examples are given for each of these factors. Other factors may be influential in TPRs decision on whether to investigate, for example the extent of openness and timeliness of communication with TPR.

The new offences are similar to TPRs existing power to issue Contribution Notices. However, there are differences including the burden of proof in prosecuting for the new offences lying with the prosecution (in establishing a reasonable excuse, TPR will expect documented explanations for actions taken), the new offences can be committed by anyone (not just the employer) and the new offences can only be committed where a s75 debt is due (whereas a CN can be issued regarding a debt which might become due).

TPR indicate features which they will consider in selecting cases for investigation. These are noted as:

- The primary purpose being the abandonment of the scheme without appropriate mitigation
- Significant financial gains have been made to the detriment of the scheme
- Unfairness in the treatment of the scheme
- The trustees, TPR/PPF have been misled or not appropriately informed.

In investigating and prosecuting, TPR's policy will be to engage early, adopting a 'fair, balanced and impartial' approach.

D Fairs, TPR's Executive Director of Regulatory Policy, Analysis and Advice, commented on TPR's approach in a speech delivered on 30 March:

"Our goal is to work with Department for Work and Pensions, the regulated community and wider industry and stakeholders to ensure the new measures are introduced in an effective way. We will we only use these powers where it is appropriate and reasonable to do so."

Legislation

Pensions Scams: Empowering Trustees and Protecting Members - consultation

On May 14 the DWP issued a consultation on draft regulations (The Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021). The Ministerial Foreword reiterates that the Government is committed to working to protect people from pension scams. The new measures aim to strike a balance giving savers flexibility in their choices and at the same time protecting against scam activity. The proposed provisions empower trustees and 'put them in the driving seat' in relation to pension transfers by enabling them to prevent a transfer where there are risks to the member's savings, although it is intended that little intervention will be needed in cases which trustees consider low risk.

These regulations flow from s125 of the Pension Schemes Act 2021 and set out provisions for trustees to allow a member to transfer out of their scheme into another personal or occupational scheme. The proposed measures include 4 conditions, one of which will need to be met before a transfer can go ahead.

The first condition allowing the transfer to proceed will be for trustees to identify if the transfer is to one of a set of scheme types, namely:

— Public Service Pension Schemes,

— authorised Master Trusts,

— authorised Collective Money Purchase Schemes, or

— personal Pension providers, authorised and regulated by the Financial Conduct Authority ("FCA") which are, or are within the same group as, an insurer authorised by the PRA.

If the first condition is not satisfied, then the transfer can only occur if evidence set out in regulations is provided by the member as noted below.

In the case of transfer to a UK occupational scheme, evidence of an employment link between the scheme, the member and the employer is required – this is the second condition. The nature of the evidence required is set out in the regulations and comprises evidence of the member making a transfer to the same scheme in the last 12 months or a letter from the employer, payslips, a schedule of payments to the scheme and bank statements.

In the case of an overseas scheme ("QROPS"), if an employment link cannot be evidenced, then a residency link (demonstrating residence in the same financial jurisdiction as the QROPS for at least 6 months) must be established – the third condition. Evidence will be required of the member making a transfer to the same scheme in the last 12 months or formal residency documentation (which will vary between jurisdictions). TPR will provide guidance on the requirements.

If conditions 1 – 3 do not apply, then it will only be able to proceed if the fourth condition is satisfied. Trustees will need to determine whether 'red' or 'amber' flags are present. In the presence of a 'red' flag, trustees would be able to prevent a transfer. If 'amber' flags are present, a transfer can go ahead if the member seeks advice and gains evidence of that advice from MaPS or they have made a transfer to the same scheme in the last 12 months and taken advice in that period. Where flags are evident, trustees can request further information to assess the transfer. Standard questions to use in information gathering, aiming to provide clarity on the detail required, have been drafted by the DWP and others and are included as part of the consultation document. Should a member not provide information or evidence of taking MaPS guidance when requested, this will be a 'red' flag.

Red flags are identified as situations where:

— financial advice has been provided by those without appropriate regulatory permissions (or taken recommendations from such people)

— the member has been contacted unsolicited

— the member was offered incentives to transfer, including free pension reviews and cashback

— the member was under pressure to completer the transfer quickly.

Legislation

Pensions Scams: Empowering Trustees and Protecting Members - consultation (cont.)

Amber flags are defined as situations where:

— high risk or unregulated investment are included in the receiving scheme

— fees are being charged by the receiving scheme which are unclear or high

— the proposed investment structures are complicated or unorthodox,

— the receiving scheme includes overseas investment or any of the advisers are based overseas, and

— there has been a high volume of transfers to a single receiving scheme or involving a single adviser or firm.

Within one month of requesting a transfer or a statement of the value of their transferable rights, trustees must inform members about the conditions for transfer set out in the Regulations and the need for one of the conditions to be met before a transfer can be actioned.

The draft Regulations have received mixed reactions from the industry although commentators have welcomed further protection from scammers. The consultation ran until 10 June 2021, with the intention that the Regulations will be in force from Autumn 2021.

ESG

ESG Essentials

As ESG and Climate Change is constantly evolving and invariably in the news, we have introduced a new feature to Round-Up – "ESG Essentials" where we gather together the developments in the ESG world over the month and pull out key points for occupational pension schemes.

FCA Consultation: TCFD Disclosures for asset managers, life insurers and FCA regulated pension providers

The Financial Conduct Authority ("FCA") has published a Consultation Paper ("CP") setting out proposals to introduce climate-related financial disclosure rules and guidance for asset managers, life insurers, and FCA-regulated pension providers, consistent with the TCFD recommendations.

The FCA are also introducing a new 'Environmental, Social and Governance ("ESG") Sourcebook' in the FCA Handbook to set out proposed rules and guidance.

The proposals aim to increase transparency while remaining proportionate. The FCA's approach also aims to support the flow of information along the investment chain. In particular, to support disclosures required under the DWP's draft Regulations and Statutory Guidance for trustees of occupational pension schemes.

Taskforce of Nature Financial Disclosures ("TNFD")

The goal of the TNFD is to provide a framework for organisations to report and act on evolving nature-related risks, in order to support a shift in global financial flows away from nature-negative outcomes and toward nature-positive outcomes.

Proposed TNFD Principles:

1. Market Usability: Develop frameworks directly useful and valuable to market reporters and users, notably corporations and financial institutions, as well as policy and other factors.

2. Science-based: Follow a scientifically anchored approach, incorporate well established and emerging scientific evidence and aim to incorporate other existing science-based initiatives.

3. Nature-related Risks: Address nature-related risks that include immediate, material financial risks as well as nature dependencies and impacts and related organisational and societal risks.

4. Purpose-driven: Be purpose driven and actively target reducing risks and increasing nature-positive action by using the minimum required level of granularity to ensure achievement of the TNFD goal.

5. Integrated & Adaptive: Build effective measurement and reporting frameworks that can be integrated into and enhance existing disclosures and standards. Account for and be adaptive to changes in national and international policy commitments, standards and market conditions.

6. Climate-Nature Nexus: Employ an integrated approach to climate- and nature-related risks, scaling up finance for nature-based solutions.

7. Globally Inclusive: Ensure the framework and approach is relevant, just, valuable, accessible and affordable worldwide, including emerging and developed markets.

ESG

ESG Essentials (cont.)

AMNT Red Line Voting – revised guidance

June also saw the publication of the updated Red Line Voting, produced by the Association of Member Nominated Trustees ("AMNT").

Since its launch in 2015, there has been much regulatory change and industry development with more focus on voting and stewardship in relation to environment, social and governance matters. The guidance sets out polices which will help trustees in holding their investment managers to account in their approach to exercising voting rights and engagement.

The polices can also be used by trustees as a framework by which voting and engagement information can be requested from investment managers.

Red line policies should be applied on a comply or explain basis and not as a prescriptive method of voting.

Changes to the Red Line Voting for 2021 include:

Environmental:

- Expectation that companies to report in relation to TCFD recommendations
- Corporate lobbying to be done in alignment with the Paris Agreement

Social:

- Introduction of requirements in relation to the Modern Slavery Act

Governance:

- New linkage of CEO pay to sustainability targets, including climate change
- New Red Line regarding the alignment of CEO pension contributions to that of the company workforce.

The updated Red Line Voting can be found here.

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 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.

Pensions Dashboard Programme - plans for 2021 and data standards

The receipt of Royal Assent on 11 Feb was a significant step in the introduction of Pensions Dashboards. We now expect to see secondary legislation emerging and the Pensions Dashboard Programme ("PDP") continuing to develop at pace. This will build on recent activity.

In April the PDP issued their latest progress update report. The report confirmed that the programme remains on track with procurement of digital architecture underway and the hope of the contract being awarded in the next six months. Procurement of the identity service will also soon begin. Progress continues to be made in developing an onboarding strategy, including looking for volunteers to test the system.

Over the next six month period, procurement exercises will continue and work will include the onboarding strategy, consumer protection, user needs, design standards and collaboration to support secondary legislation emerging from the Pension Schemes Act 2021.

We have already seen some activity. During May the PDP issued a call for input on staging proposals linking into a data providers hub which contains directions for data providers such as schemes in linking up to dashboards. The proposals aim to balance the competing demands of consumers, data providers and the PDP in ensuring the systems work. Staging is proposed in three waves:

— wave one (starting in April 2023 and running for two years): largest schemes (1000+ memberships)

— wave two: medium schemes (100 to 999 memberships)

— wave three: small and micro schemes (99 or less memberships)

Wave one will be further split down into three cohorts; master trusts and FCA regulated providers of personal pensions; defined contribution schemes used for Automatic Enrolment; and all remaining occupational schemes with 1,000+ memberships (in order of size) [the largest defined benefit (DB) schemes to onboard in 2023].

The PDP have also issued a response to the earlier call for input on the identity service which revealed some concerns with knowledge of the structure of the core architecture, clarity around the identity proposals and solution and alignment of legislative requirements. It is hoped that the information provided within the data providers hub will alleviate some of these concerns, with more information to follow.

Another significant stage for the PDP came in April with the issue of an ITT for the contract to supply major elements of the digital architecture, including the pension finder service ("PFS"), the consent and authorisation service and the governance register.

The current timeline outlines that during 2021-2, the PDP will undergo a 'develop and test phase' before moving onto voluntary onboarding and ongoing testing followed by staged onboarding and a 'Dashboards Available' point in 2023.

Member engagement is central to the success of the PDP.

This is recognized in the production of a Rapid Evidence Assessment report, published in June, which discusses barriers to engagement and ways they may be overcome. Barriers are identified as inertia, bias to immediate rewards, friction (inconvenience) costs, choice overload, and lack of knowledge or ability. Insights can be drawn from behavioural science with key strategies proposed to lessen these barriers including timely prompts to engage, encouraging members to consider their future position, simplifying processes and providing 'rules of thumb' to simplify complex decisions. Demographics are also seen to contribute to the level of member engagement with older members and those more financially literate being more likely to engage. The key information to include is Estimated Retirement Income (ERI), this can be helpfully supported by future and current balances and the inclusion of supporting guidance. The report also notes that it may be helpful to wait until dashboards are almost complete, as users may be deterred from engagement if information is missing. Presentation is also critical to engagement and will require careful consideration. Dashboards should continue to evolve even after their 'go live' date.

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

This follows the issue in March of The Pensions Administration Standards Association's ("PASA") issue of the first of their intended series of guides for schemes looking at how to start preparing for pensions Dashboards.

The PDP data providers hub includes a timeline and steps needed for connection to the dashboards ecosystem. It sets out what data providers need to do at each stage of the programme.

During phase one (programme set up and planning) providers will need a data audit to identify gaps in both 'find' and 'view' data and plan how to fill them. An assessment will need to be made to how much of this data is non-digital and how this can be included. Data cleansing for dashboard should complement other data cleanse activity. Providers need to understand who they will need to communicate with to prepare; this may include software providers in considering connection to the dashboard ecosystem.

Phase two (develop and test) will see early testing and volunteer data providers. Data providers will need to decide on their approach to matching data, ie which fields of data to use and conduct an audit to determine any gaps in this data. Partial matches will also need consideration. Providers will need to continue to ensure that 'find' data is complete and accurate. The approach to 'view' data provision (ie 'on demand' or stored) will need to be considered. Change may be needed to the basis for providing Estimated Retirement Income (ERI) as a result of PDP and industry working group findings. Dependencies on third parties should be understood and data providers will need to consider connection in more detail. The impact of high volumes of traffic from the dashboard ecosystem should also be considered – it is estimated that 6-9 million users will access the system each year – and whether any additional software solution would be advantageous to manage this.

By phase three (voluntary onboarding and ongoing testing), data providers should be progressing data cleansing and ensuring completeness of information. On an ongoing basis prior to connecting, providers should be validating and auditing data. An approach to data matching and ERI reporting should be in place. Plans for working with dependencies should be in place as should connection plans, including implementation and testing to tie into compulsory onboarding dates. Providers may wish to consider any advantages of voluntary onboarding. If data mapping to allow for additional software is being undertaken, this should be progressing.

Once phase four (staged onboarding) is reached, providers should be confident in the availability of digital data. The matching basis and delivery of estimated retirement income ("ERI" should have been tested and assessed before the staging date. Dependency plans should be validated and plans for connection with the ecosystem be in progress to tie into staging date. This should include testing of find and view functions. Providers should be familiar with the onboarding process and be in a position to start onboarding. Workload will have been considered together with processes for handling queries.

The recent activity follows the December release of the PDP 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 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).

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

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

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.

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.

Small Pots Working Group Report

On 24 May the DWP released a consultation on proposals to limit the charging of flat fees on small pots (the threshold is proposed at £100) to come into force in April 2022. The aim is to prevent any undermining of auto enrolment by protecting members from erosion of their pots. The proposals aim to strike a balance between member protection and financial sustainability of providers. The consultation also seeks views on proposals for a universal charging structure allowing a single percentage annual management charge, based on the value of the member's pot within the default fund with the aim of increased comparability between products. Views are also sought on whether the move to a single charging structure would impact employer choices.

This follows after 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.

— 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.

Small Pots Working Group Report (cont.)

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 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.

The recommendations from the Small Pots Working Group will be taken forward by a new industry group convened by The Pensions and Lifetime Savings Association and the Association of British Insurers. The group will focus on administration processes underpinning a long-term future consolidation model, looking at data-match requirements, common data standards and a low-cost transfer process. A progress report is expected in the summer.

TCFD recommendations: revised draft climate change regulations and Statutory Guidance issued

On 8 June 2021, the DWP issued its response to the "Taking action on climate risk: improving governance and reporting by occupational pension schemes" consultation alongside revised draft Regulations and Statutory Guidance. There are few changes to the both the the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 ("the Climate Change Governance and Reporting Regulations") and Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 ("the Miscellaneous Provisions Regulations"), and the revised Statutory Guidance provides more clarity on certain requirements.

Schemes with relevant assets* of £5bn or more on the first scheme year end date to fall on or after 1 March 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 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.

The DWP have now refined the definition of a relevant contract of insurance, so that in the case of bulk-annuity contracts it does not require:

- **an exact matching of the cost of benefits;**
- **the intention to meet costs in all circumstances – only irrespective of future financial market conditions or scheme member longevity; or**
- **the insurer having unfettered discretion in relation to the investment policy of the assets used to meet its liabilities under the contract.**

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 response also clarifies that where trustees are subject to the requirements for part of a scheme year, their report need only cover that part scheme year.

The trustees must include a link for 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.

TCFD recommendations: revised draft climate change regulations and Statutory Guidance issued (cont.)

The 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 scheme governance activities otherwise than as a trustee, takes adequate steps to identify, assess and manage climate-related risks and opportunities which are relevant to the governance activities they are undertaking; and

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

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 in which the requirements apply and thereafter where trustees have determined that it is appropriate to undertake new scenario analysis or the trustees have not undertaken scenario analysis in the previous two years, new scenario analysis must be undertaken.

Trustees must, in each scheme year except for the first scheme year in respect of which the requirements apply, review the most recent scenario analysis to determine whether it is appropriate to undertake scenario analysis to ensure they have an up to date understanding.

Whenever new scenario analysis is undertaken, the three year cycle is automatically reset.

Note, schemes with DB and DC sections will need to do separate scenario analysis. The Statutory Guidance provides more detail on multi-section schemes.

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 ensure that theses processes integrated into their overall risk management of the scheme.

TCFD recommendations: revised draft climate change regulations and Statutory Guidance issued (cont.)

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 will not have to collect and report on Scope 3 emissions in the first scheme year that they are subject to the requirements. The DWP have clarified the timing of the requirements to make clear that they must be carried out in each scheme year, and that where metrics are dropped following review, replacement metrics must be selected.

Each scheme year, trustees must, and as far as they are able, obtain the data to calculate their selected metrics, 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.

Where the first year of application is a part scheme year, activities carried out within the same scheme year in advance of the date of application may be relied upon to meet the requirements. The DWP have also made clear that when trustees drop out of scope and then subsequently come into scope again, they must select metrics in the same way as they are required to do in the first scheme year.

In the first year the requirements apply, trustees must set a target for the scheme in relation to at least one of the metrics which they have selected to calculate and in each scheme year measure, as far as they are able, the performance of the scheme against that target. Having reviewed that performance, and determined that a target should be replaced, trustees must set a new target in relation to one of the chosen metrics.

The DWP have clarified that performance against the target is the only criterion which trustees must consider in determining whether to retain or replace that target, although they are free to choose others.

"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.

The Statutory Guidance provides more support for trustees, recognising the data restrictions and gaps when calculating scenario analysis and metrics. It also acknowledges the challenges trustees may face when quantifying climate risks for some sovereign bonds, relevant contracts of insurance, asset-backed contribution structures and derivatives. Trustees of defined benefit schemes may also experience limitations in relation to liabilities, funding strategy and employer covenant analysis.

TKU requirements

Trustees are 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. The DWP have amended the drafting of the Miscellaneous Provisions Regulations in relation to knowledge and understanding of opportunities, to align with the language around risks. In relation to both opportunities and risks, clarification has been added that the intention is for trustees to have sufficient knowledge and understanding to enable them to meet the climate governance requirements in Part 1 of the Schedule to the Climate Change Governance and Reporting Regulations.

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.

TCFD recommendations: revised draft climate change regulations and Statutory Guidance issued (cont.)

Disclosure requirements

Trustees are required to publish their TCFD report on a publicly available website, free of charge, within 7 months of the scheme year-end. 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. 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.

Review

Review of the effectiveness of the Regulations and Statutory Guidance for schemes in scope, assessing whether the Regulations remain appropriate, and whether or not they should be extended to smaller schemes will 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. In the response, the DWP have also amended the wording regarding the mandatory penalty, to make clearer that it only applies where TPR are of the opinion that a person has failed to publish a report on a publicly available website, accessible free of charge.

Concluding comments

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.

The FCA has recently published new proposals on climate-related disclosure rules for listed companies and certain regulated firms. In the consultations, the FCA is proposing to extend the application of its TCFD-aligned Listing Rule for premium-listed commercial companies, to issuers of standard listed equity shares and to introduce TCFD-aligned disclosure requirements for asset managers, life insurers, and FCA-regulated pension providers, with a focus on the information needs of clients and consumers.

News in brief

TPR’s Equality, Diversity and Inclusion Strategy

On 24 June 2021, The Pensions Regulator (TPR) published its Equality, Diversity and Inclusion Strategy, setting out “how it plans to lead by example to create a fairer and more inclusive culture across the pensions industry…”.

The Strategy sets out how TPR will embed diversity and inclusion throughout its organisation and how it will support its regulated community to do the same. With a road map and new targets, the Regulator sets out its aims:

— to be a fair, diverse and inclusive employer;

— to build a collective understanding of why pensions inequalities occur and work in partnership with others seeking to reduce them; and

— to promote higher standards of equality, diversity and inclusion among TPR’s regulated community

The objectives detail how TPR’s workforce and practices will become more diverse and inclusive. It also sets out how the Regulator will work with the industry so that governing bodies become more diverse and inclusive in their decision making.

TPR is calling for people from across the pensions industry, government and other regulators to sign up for its Equality, Diversity and Inclusion webinar (tprevernts.org.uk) in July to learn more about the strategy and discuss next steps.

kpmg.com/uk