BRIEFING

TRAVERS SMITH

Pension Schemes Act 2021: what happens next?

Updated September 2021

The Pension Schemes Act 2021 makes significant changes to pensions law in several areas.

The content includes provisions on:

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

None of the substantive provisions took effect on Royal Assent: commencement orders are needed. As we note below, regulations are also required before many of the provisions can be brought into force. These have now started to be made and several aspect of the Act will take effect from 1 October 2021.

In this briefing we look at each of the above aspects in turn and note what the Act will change. We also note the developments since Royal Assent and what is known about what will happen next, and when.

DB scheme funding and investment

DB schemes will need to have a "funding and investment strategy". This is a strategy for ensuring that benefits can be provided over the long term. It will have to include a targeted funding level(s) to be achieved by a particular date(s) and information on the investments intended to be held as at particular dates. The detail, including on timing, is left to future regulations.

After determining or revising such a strategy, trustees will have to prepare a "statement of strategy": this must describe the funding and investment strategy (in terms agreed by the employer). It will also (in consultation with the employer) have to include information on:

- the extent to which the strategy has been successfully implemented;
- steps to be taken to remedy any deficiencies;
- the main risks in implementing the strategy and how they will be mitigated or managed; and
- reflections on any relevant significant decisions.

Scheme funding 'technical provisions' (actuarial assumptions etc.) will have to be calculated in a manner consistent with the strategy.

Regulations may require other matters to be included. They may also require trustees to send their statement to the Pensions Regulator. There is nothing in the Act about disclosure to members or on a public website but it would be simple for the Government, if it wished to do so, to amend the existing disclosure of information regulations for that purpose.

Trustees will have to send copies of all actuarial valuations to the Pensions Regulator. The Regulator will be able to require trustees to revise their funding and investment strategy in accordance with its direction if it thinks they have failed to comply with the legislation.

Regulations may also specify matters to be taken into account, or principles to be followed, in determining whether or not a recovery plan is (as required under the Pensions Act 2004) "appropriate", having regard to the nature and circumstances of the scheme.

Separately, the Pensions Regulator has consulted on a new framework for the regulation of DB scheme funding. It proposes overarching funding principles based on its existing focus on integrated risk management and long-term planning.

The proposal is that it will introduce a new "fast track" valuation approach with fixed (but not yet determined) parameters: schemes adopting this approach can expect minimal funding scrutiny. The alternative, equally acceptable, "bespoke" approach will allow schemes to deviate from the fast track parameters without regulatory intervention on funding if they can explain and evidence their decisions to the satisfaction of the Regulator, including how risk is being managed.

The new regime will be introduced by a replacement DB scheme funding code of practice. The Pensions Regulator has said that it will publish a consultation on the text of this new code towards the end of 2021, alongside its substantive response to the first consultation. In response to concerns raised in Parliament, Government minister Baroness Stedman-Scott said at the Bill's final stage that the code of practice "will acknowledge the position of open and less mature schemes".

For more detail, see our March 2020 briefing note DB pension scheme funding – Pensions Regulator consultation.

What happens next?

We do not yet know exactly when these provisions will take effect. The Pensions Minister told Parliament on 2 March 2021 that the consultation on regulations will be later this year, following engagement with the Pensions Regulator and other key interested parties: this is later than previously expected. As regards the funding and investment strategy, the regulations should include information on timing, the required level of detail, and what trustees will have to take into account. They should also include provisions on determining whether or not a recovery plan is "appropriate".

The most recent information from the Pensions Regulator is that its code of practice consultation is now expected towards the end of 2021, with the code coming into force in late 2022 or early 2023.

Contribution notices

There will be two new contribution notice grounds that the Pensions Regulator will be able to apply in relation to an act or failure to act (these are in addition to the existing material detriment and section 75 debt avoidance grounds, which will continue to be available to the Regulator):

- **Employer insolvency test:** This test is whether, if a section 75 employer debt had fallen due (as a result of employer insolvency) immediately after the act or failure to act, the act or failure to act would have materially reduced the amount of the debt likely to be recovered by the scheme.

  A statutory defence will apply where the Regulator is satisfied that due consideration was given in advance and it was reasonable to conclude that there would not be a material reduction in the likely recovery. This defence also requires that where the party considered that there might be such a reduction, all reasonable steps must have been taken to eliminate or minimise the potential for the act or failure to have such an effect.

  For this test to apply, the value of scheme assets must have been less than the value of liabilities (on the section 75 basis) immediately after the act or failure to act as estimated by the Pensions Regulator. There is a further separate statutory defence in this regard.

- **Employer resources test:** This test is whether the act or failure to act reduced the employer's resources by an amount that is material, relative to the estimated section 75 employer debt. Regulations currently awaiting the approval of Parliament will spell out how those resources are to be measured for this purpose.

  A statutory defence will apply where the Regulator is satisfied that due consideration was given in advance and it was reasonable to conclude that there would not be a reduction in the employer's resources. This defence also requires that where the party considered that there might be a reduction, all reasonable steps must have been taken to eliminate or minimise the potential for the act or failure to have such an effect.

There appears to be a good deal of overlap between these two tests. As for existing contribution notice grounds, the Regulator must be of the opinion that it is reasonable to impose liability.

A required Pensions Regulator code of practice will set out circumstances in which the Regulator envisages issuing a contribution notice in relation to the two new tests. This will be by way of a replacement of existing Code of Practice 12, which currently addresses circumstances in relation to the 'material detriment test' (which the new code will also do). A consultation on the draft code and accompanying guidance closed on 8 July 2021 and the final text is awaited.

The effective date for the calculation of a contribution notice "shortfall sum" (which is the maximum amount for which the Regulator can issue a contribution notice) will become the last day of the scheme year to fall before the Regulator's decision to issue the warning notice (rather than, as it is now, the date of the act or failure to act). This means that, up to a point, subsequent changes in asset and liability values will be taken into account.

There will also be a new relevant matter for the Regulator to consider when assessing whether or not it is reasonable to impose a contribution notice. This will be the effect of the act or failure on the value of scheme assets or liabilities (including those of a transferee scheme).

New sanctions for failure to comply with a contribution notice without reasonable excuse will be an unlimited criminal fine or a civil penalty of up to £1 million.

What happens next?

These provisions take effect from 1 October 2021. They do not apply to acts or omissions that occurred or began before that date.

The employer resources test regulations are awaiting the approval of Parliament.

The Pensions Regulator is required to produce a code of practice on the new tests. A consultation on a draft replacement Code of Practice 12 and accompanying guidance ran until 7 July 2021. The final text is awaited.

The Regulator's clearance guidance needs to be updated but a timescale for this has not been announced.

New criminal offences and financial penalties

There will be two new criminal offences relating to pension scheme benefits. These are very broad but there will be defences. Commission of either offence can result in an unlimited criminal fine and/or imprisonment of up to seven years. The Pensions Regulator (as well as the usual criminal authorities) will be able to prosecute. Alternatively, and with a less weighty burden of proof, the Regulator will be able to seek a civil financial penalty of up to £1 million.

Contrary to the Government's original consultation, which suggested an offence based on “wilful or reckless behaviour”, the Act is much broader. It introduces two new criminal offences as follows:

- **Avoidance of employer debt:** An offence is committed where there is an act, failure to act or course of conduct that intentionally and without reasonable excuse:
  - prevents the recovery of the whole or part of a section 75 employer debt (or contingent debt);
  - prevents a section 75 employer debt from becoming due;
  - compromises or otherwise settles a section 75 employer debt; or
  - reduces the amount of a section 75 employer debt that would otherwise become due.
- **Conduct risking accrued scheme benefits:** An offence is committed where, without reasonable excuse, there is an act, failure to act or course of conduct that detrimentally affects in a material way the likelihood of accrued scheme

benefits being received. To be held responsible, a person must have known or ought to have known that the act, failure or course of conduct would have that effect.

The civil penalties are similarly (but not identically) worded and also include a defence based on reasonableness. A significant difference from the criminal offence provisions, however, is that a wider group of people is in scope: the civil penalties also apply to anyone who knowingly assists in a relevant act or failure to act.

In all cases, there are exemptions in respect of insolvency practitioners, when acting as such.

These new measures are similar to existing contribution notice grounds. Pensions Regulator guidance can give comfort with regard to contribution notices by giving a sense of when it expects to exercise its powers but comfort is not so easily achieved in relation to the new criminal offences and civil penalties: for those, clearance is not available and it is not only the Regulator who will be able to prosecute the criminal offences.

A key difference from contribution notice grounds is that there is no need for the person being prosecuted or fined to be a scheme employer or even connected to or associated with one. There are therefore concerns about the potential criminalisation of ordinary business activities and the exposure in some circumstances of parties such as trustees, advisers, banks and trade unions. The Government dismissed these, saying that the legislation is aimed at dishonest and irresponsible behaviour and that it needs to ensure that there are no loopholes. There is, of course, a "reasonable excuse" defence (and a similar defence for the civil penalties), with the onus on the Regulator to prove that an excuse or conduct was not reasonable, but there is no explanation of what these defences are intended to cover. All those involved in corporate activity should therefore now be bearing these new measures in mind when considering taking steps (or omitting to do something) that could directly or ultimately affect DB pension scheme members' benefit security.

The Pensions Regulator will be issuing guidance on prosecuting the criminal offences, a draft of which was published for consultation on 11 March 2021. The final text is awaited.

What happens next?

These provisions take effect from 1 October 2021 and apply to acts or omissions on or after that date.

We hope that the Pensions Regulator's prosecution policy - which will be key - will have been finalised before the legislation takes effect. The consultation on the draft policy closed on 22 April 2021 and the final version is awaited.

An updated Pensions Regulator monetary penalties policy is expected. There may also be further guidance from the Regulator on the use of its overlapping criminal offence, civil penalty and contribution notice powers. There may also be memoranda of understanding between the various potential prosecutors.

Notifiable events and Pensions Regulator investigations

There will be a new, more intrusive regime for certain notifiable events (i.e. events that have to be notified to the Regulator) that occur in relation to scheme employers.

There is no detail in the Act on the events that will be in scope or on when notification will be required. Significant detail will be in regulations, on which an industry consultation is expected. The Government's February 2019 consultation response, however, indicated that the new notifiable events will be:

- the "sale of a material proportion of the business or assets of a scheme employer which has funding responsibility for at least 20% of the scheme's liabilities"; and
- "granting of security on a debt to give it priority over debt to the scheme".

This new regime is also expected to be applied by regulations to the existing notifiable event of a decision by a controlling company to relinquish control of the employer.

Notifications under the new regime will also have to be given to the scheme trustees.

The context here is that the Government wants the Regulator and scheme trustees to hear about a wider range of potentially concerning corporate activity and to hear about it while it may still be possible to intervene, rather than after everything is concluded.

The Pensions Regulator is required to produce a code of practice and is expected to update its relevant guidance.

Regulations can impose the new duties on not just the scheme employer but also a person connected or associated with it, or any other specified person. The Government's consultation response referred to a transaction's "corporate planners" being in scope.

Notifications will have to be accompanied by a statement (referred to during the pre-Bill consultation as a "declaration of intent"). Details will be in regulations but it is expected that this will need to set out the implications for the scheme of the proposed transaction (or other corporate activity) and how any risks will be mitigated.

The Regulator will be able to impose civil penalties of up to £1 million for breaches of the notifiable events requirements (including the existing ones) and for knowingly or recklessly giving false or misleading information to the Regulator or to trustees. The offence of misleading the Regulator is also extended to notifiable events.

The Regulator will also have new powers to interview and inspect premises, with new fixed and escalating penalties for non-compliance that are also extended to breaches of the existing provision of information requirements.

What happens next?

Regulations are needed to specify all the detail here, including what the new notifiable events will be; at what point a notification in relation to a transaction will be required; and the content of the "accompanying statement". A consultation on draft regulations is expected "later this year" with commencement "as soon as practicable thereafter" – likely to be some time in 2022.

A Pensions Regulator code of practice is also required, with no deadline specified in the Act. The Pensions Regulator's guidance is also expected to be updated.

The new £1 million maximum penalty applies from 1 October 2021 in respect of the existing notifiable event requirements.

Climate change

The Act includes a broad power for the Government to impose requirements on DB and DC occupational pension scheme trustees "with a view to securing that there is effective governance of the scheme with respect to the effects of climate change".

This may include requirements about:

"(a) reviewing the exposure of the scheme to risks of a prescribed description;

(b) assessing the assets of the scheme in a prescribed manner;

(c) determining, reviewing and (if necessary) revising a strategy for managing the scheme's exposure to risks of a prescribed description;

(d) determining, reviewing and (if necessary) revising targets relating to the scheme's exposure to risks of a prescribed description;

(e) measuring performance against such targets;

(f) preparing documents containing information of a prescribed description."

There will also be a requirement to publish information.

The Government's intentions here reflect June 2017 recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Our Sustainable Business Hub includes materials that trustees may find useful with regard to the developing law in this area.

The Government consulted on policy proposals for the new duties (a) to (f) above to be imposed by regulations under the Act, and then on draft regulations.

The regulations and supplementary regulations have now been made. Trustees will have to comply with requirements on governance, strategy, risk management, scenario analysis, metrics and targets relating to the assessment of climate risks and opportunities. They will also be required later to make public disclosures about the steps they have taken in these areas. Additional TKU (trustee knowledge and understanding) expectations are being introduced in this area.

The new requirements will first apply to the largest schemes with assets in excess of £5 billion (and authorised master trusts and collective money purchase schemes) from 1 October 2021, with first public disclosures to be made within seven months of the end of the scheme year in which the governance requirements start to apply. Schemes with assets of £1 billion or more would become subject to the requirements a year later, with scope to a consider an extension to smaller schemes from 2024.

The following guidance notes have also been finalised:

- Government statutory guidance for trustees on governance and reporting of climate change risk; and
- Pensions Climate Risk Industry Group non-statutory guidance: "Aligning your pension scheme with the Taskforce on Climate-Related Financial Disclosures recommendations".

Pensions Regulator guidance is expected to be finalised shortly. The consultation on a draft closed on 31 August 2021.

Asset managers, listed and large companies, and banks, building societies and insurers (including personal pension providers) will face their own disclosure requirements from 2022 or 2023. The disconnected timetables mean that some pension schemes will have to make disclosures before their asset managers have to. Helpfully, the FCA has said that it will be mindful of the information that occupational pension scheme trustees will need when prescribing the disclosures that asset managers will need to make. Its consultation on rules for regulated firms closes on 10 September 2021 and a policy statement is expected before the end of the year: see our Financial Services and Markets department's briefing for more information.

What happens next?

An ambitious timetable has been set but there are now regulations, statutory guidance and non-statutory guidance, with final Pensions Regulator guidance to follow. As noted above, initial commencement is on 1 October 2021.

The FCA's rules for TCFD-aligned disclosures by asset managers, life insurers and FCA-regulated pension providers should be finalised later this year.

Transfer scams

With a view to combating pension transfer scams, the Government is able to prescribe new conditions on trustees making statutory transfers, including (but without limitation):

- a condition relating to the member's employment or place of residence and to the provision of evidence about those matters; and/or
- a requirement that the member has obtained information or guidance from a prescribed source and proves to the trustees that they have complied or do not have to do so.

A consultation on draft regulations proposed, broadly, that:

- Transfers to certain categories of low risk scheme can continue unimpeded – these are public sector schemes, authorised master trusts, authorised collective DC schemes, and personal pension schemes operated by regulated insurers.
- In other cases, the individual can transfer if they demonstrate a substantial employment link with a scheme employer (in the case of an overseas transfer to a QROPS, evidence of residence in the relevant country can alternatively be supplied) or a previous transfer to the same scheme in the last 12 months. The regulations would describe type(s) of evidence the member could provide in order to meet these conditions.
- An amber and red flag system will apply to statutory transfers that do not fall within the above categories and in these cases, individuals can be asked to supply further information so that trustees can identify whether 'flags' are present. Red flags, specified in the draft regulations, mean that that there is no statutory transfer right; amber flags, also set out, mean that the member has to take new scam-specific guidance from the Money and Pensions Service before the transfer right applies. A failure by the individual to respond to a request for information is a red flag.

What happens next?

The Government has consulted on the proposed regulations and the final version is awaited.

Commencement of these provisions is expected in "early autumn", after the regulations are finalised.

Pensions dashboards

There is legislation to facilitate the establishment of pension dashboards. These will be websites on which individuals should ultimately be able to view information about all of their pension entitlements, including the state pension. The first dashboard will be run by the Money and Pensions Service (MaPS), with commercial operators expected to follow. The initial public launch of the MaPS dashboard is now not expected until 2023.

Pension schemes will be required to provide their data to a single "pension finder service", the creation of which will be overseen by an industry delivery group, the Pensions Dashboards Programme. Following a call for input, an initial version of the proposed data standards was published late last year. There is not yet a timetable setting out by when schemes will need to provide data.

The Pensions Administration Standards Association has published useful guidance for trustees and providers on how to start getting ready for pensions dashboards.

What happens next?

This is a slow-moving project. Trustees await all the detail of what information they will be required to submit, in what format and by when. It is currently looking as though most schemes will first have to supply data in 2023. A consultation on draft regulations is expected "later this year", with the regulations then needing to be laid before Parliament for debate (expected to be in 2022). The initial launch is currently expected to be in 2023.

Collective money purchase benefits

The largest part of the Act is concerned with establishing a framework to allow schemes to provide collective money purchase benefits (no longer referred to as collective defined contribution) in compliance with a specified model.

The model operates as an occupational pension scheme for single or associated private sector employers. Target defined benefits are communicated but not promised. Investments are pooled (not selected by members) and pensions are paid from the scheme rather than by annuity purchase. Adjustments are made to pensions in payment and to benefit targets, based on the funding position from time to time.

This is being introduced to allow Royal Mail to set up such an arrangement for its staff. Other employers may use the same framework but will not have flexibility over benefit design. Arrangements will need to be authorised by the Pensions Regulator, with requirements similar to those under the master trusts authorisation regime.

What happens next?

Detailed regulations are required on just about every aspect of these proposals. A consultation on draft regulations closed on 31 August 2021 and the outcome is awaited.

The Pensions Regulator also needs to publish its authorisation criteria. Only then will employers be able to consider whether they wish to follow Royal Mail's lead.

The timescale for commencement is not yet known.

Pension Protection Fund compensation

The Act amends PPF compensation legislation retrospectively in order to reflect aspects of policy intent and PPF practice. The amendments are in respect of provisions as they apply to members who transferred benefits to a DB scheme and were granted a fixed pension transfer credit. (Note that this only concerns fixed pension transfer credits: there is no similar issue as regards 'added years' transfer credits.)

This change of law follows *Beaton v Board of the Pension Protection Fund*, in which the individual successfully claimed that the PPF compensation cap should apply separately to the pension he had accrued under the scheme and his fixed pension transfer credit, thereby entitling him to higher compensation than if the two were aggregated for that purpose.

The ruling was based on the judge's finding that fixed pension transfer credits are not benefits attributable to pensionable service for the purposes of the legislation.

The outcome of the *Beaton* case stands with regard to the application of the compensation cap but the judge's finding also had potentially adverse implications for individuals as regards other aspects of the calculation of PPF compensation. It is those implications that are being addressed. Regulations had already amended the law going forward to provide that fixed pension transfer credits are to be treated as attributable to pensionable service, except when aggregating benefits for the purposes of applying the compensation cap. The Act makes that change fully retrospective.

What happens next?

This provision was commenced on 31 May 2021.

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