BRIEFING

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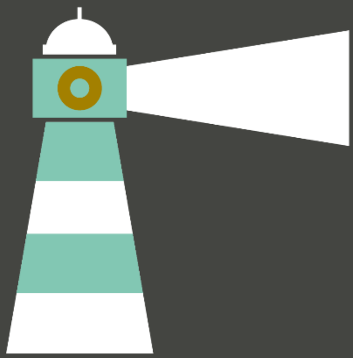

What's Happening in Pensions

Issue 96 – July 2022

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PENSIONS RADAR: You may also be interested in the latest edition of Pensions Radar, our quarterly listing of expected future changes in the UK law affecting work-based pension schemes. A new issue is due later this month.

SUSTAINABILITY MATERIALS: Our Sustainable Business Hub includes a section on ESG and sustainable finance issues for pension schemes and their sponsors.

Climate-related reporting

Consultation outcome

The Government has laid regulations adding to the TCFD climate-related governance and disclosure requirements for pension schemes. As proposed in the recent consultation, there will be an additional climate metric reporting obligation in relation to the Paris Agreement goal of limiting the global temperature increase.

The regulations amend the Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (see WHiP Issue 90) to require trustees subject to those regulations to calculate and disclose a portfolio alignment metric, setting out the extent to which their investments are aligned with the Paris Agreement goal of limiting the global average temperature increase to 1.5 degrees Celsius above pre-industrial levels. This requirement applies in addition to the existing requirements for in-scope schemes to calculate and disclosure a minimum of one absolute emissions metric, one emissions intensity metric and one additional climate change metric.

The principal regulations apply from 1 October 2021 to schemes with relevant asset values over £5 billion and authorised master trusts and (in future) collective DC schemes. Schemes with relevant asset values over £1 billion will be in scope from 1 October 2022. The new requirements will apply to all those schemes from 1 October 2022.

The consultation proposals (see WHiP Issue 92) are unchanged but there are some minor changes to the text of the draft regulations in response to specific points of concern on the detail. In this regard, the consultation response says:

> *"In particular, we have addressed an inconsistency in the regulations to ensure that - in a scenario where trustees of a scheme are caught by the requirements of Part 1 of the Climate Change Governance and Reporting Regulations from 1 October 2021 but fall out of scope before 1 October 2022 and then fall back into scope at a later date - in the first scheme year in which the new requirements apply, they can also rely on the easement set out in Part 1, paragraph 21 of the Schedule to the Climate Change Governance and Reporting Regulations, in respect of the relevant new portfolio alignment metric requirements, as it is the first time the trustees have to select and calculate a portfolio alignment metric."*

The statutory TCFD guidance (see WHiP Issue 89) has been updated to reflect the new requirements. Changes from the consultation draft include the following:

- It now emphasises the point that trustees should describe the methodology and data assumptions used when disclosing their portfolio alignment metric.
- The 'Carbon Price(s) (external and shadow/internal)' and 'Amount of senior remuneration impacted by climate considerations' metrics have been removed from the list of additional climate change metrics, as they are not appropriate to pension schemes.
- In response to some respondents suggesting the expansion of portfolio alignment tools in the statutory guidance, the Carbon Risk Real Estate Monitor tool (CRREM) has been added as a tool that trustees can use to assess the net zero alignment of their real estate holdings.
- An inaccurate 'net zero' definition paragraph has been removed.

The non-statutory PCRIG guidance (see WHiP Issue 87) and Pensions Regulator guidance (see WHiP Issue 93) are also expected to be updated to reflect the amended legislation.

TPR blog post

David Fairs of the Pensions Regulator had earlier written a blog post on TCFD reporting. This includes comments intended to address concerns about the potential for fines for the 100 or so schemes in scope since 1 October 2021, which are soon to publish the first statutory reports. He says that the Regulator does not anticipate issuing penalty notices other than where the report has not been published (where a mandatory penalty of at least £2,500 applies) or where it is clear that the trustees have not made a genuine effort to comply with the regulations (for which there would be a discretionary penalty of up to £50,000).

Stewardship guidance

The Government has finalised stewardship guidance for pension schemes including non-statutory guidance in relation to statements of investment principles (SIPs) and statutory guidance in relation to implementation statements (ISs). The statutory guidance applies to ISs in respect of scheme years ending after 1 October 2022. The non-statutory guidance on SIPs applies immediately but is not mandatory.

The guidance is intended to improve stewardship by occupational pension schemes including, in particular, voting and engagement and interaction with investment managers. Some points to note are as follows:

- The guidance highlights where disclosures can align (where applicable) with trustees' reporting under the UK Stewardship Code.
- There is content on how financially material and non-financial factors should be covered in the SIP and the IS and on trustees allowing members to express their views (and any resulting action).
- It now encourages schemes to produce member-facing summary versions of the SIP and IS (with signposting to the full document) if scheme-specific research has found that members are more likely to engage with a different style of communication.

The Government will not now publish a voting or engagement reporting template. Instead, it refers readers to the PLSA template and ICSWG guidance, whilst noting that they could benefit from further development.

The same consultation response as mentioned above, in relation to climate-related reporting, discusses comments and changes.

Transfer conditions

The Government and the Pensions Regulator have issued a joint statement following criticism of the transfer conditions regulations and unaligned Pensions Regulator guidance (see our briefing Pension scams: new statutory transfer right restrictions). Concerns relate to the overseas investment amber flag and the incentives red flag.

Changes have been made to the Regulator's guidance. These are intended to stress that the amber and red flag system just applies to statutory transfers and trustees can still use discretionary powers (where they have them) to make non-statutory transfers if they consider there is no risk.

Many schemes do not have a discretionary transfer power and that there is no statutory discharge for such transfers (and schemes cannot insist on the member signing a discharge form for a discretionary transfer if there is a statutory right). Calls therefore remain for the regulations to be amended. A Government report on the regulations is due by 18 months after they came into force, i.e. by 30 May 2023.

Pension scams

A blog post by Nicola Parish of the Pensions Regulator highlights the increasing risks of investment scams.

She notes that the use of international SIPPs (UK registered SIPPs that invest internationally) is now prevalent, with individuals living overseas being particular targets for these scams. They are often approached by local advisers or intermediaries via social media or sometimes by cold calls from outside the UK. A short summary report gives some more detail of the scope and nature of scam threats.

Ms Parish calls on more pension providers, trustees and administrators to sign up to the Pledge campaign and to report scams to the authorities. A new pdf guide addresses what and how to report.

Investment consultancy and fiduciary management

The Government has published a consultation response and laid final draft regulations before Parliament for approval, regarding its regime for the setting of objectives for investment consultants and tendering for fiduciary management services. This legislation will replace corresponding requirements of the 2019 Competition and Markets Authority (CMA) Order. The Pensions Regulator will become the supervising authority in place of the CMA.

Background

As set out in our 2019 briefing note 'Investment consultancy and fiduciary management: a dose of CMA medicine', the CMA Order had the following effect (with some exemptions):

- **Investment consultancy:** By 10 December 2019, trustees had to set strategic objectives for their existing investment consultants and, from then on, set them when engaging new investment consultants.
- **Fiduciary management:** Trustees who wish to delegate investment decisions for 20% or more of their scheme assets to a fiduciary manager must, since 10 December 2019, run a competitive tender with at least three unrelated firms. Trustees who had appointed such a fiduciary manager without a tender on or before 10 June 2019 must put the service out to tender, generally within five years from the commencement date of the existing arrangement.

Differences between final regulations and CMA Order

Some differences between the final regulations and the CMA order are as follows:

- The regulations refer to "objectives" for investment consultants rather than (in the CMA Order) "strategic objectives", though the intended effect does not seem to be different.
- As well as the setting of objectives for investment consultants, trustees will be required to measure performance against the objectives annually and review the objectives every three years (including where set in accordance with requirements of the CMA Order) or following a significant change in investment policy.
- The exemptions are different in some respects and will need to be checked on a case-by-case basis. (This is partly discussed below.)
- The regulations include an express exemption from setting investment objectives for a scheme's appointed legal advisers.
- There was a lacuna whereby schemes which delegated investment of 20% or more of scheme assets without a competitive tender between 11 June 2019 and 9 December 2019 would not have had to retender within five years in accordance with the fiduciary management requirements. That is now closed and an estimated 19 tender exercises will now have to be undertaken within that five year period.
- The Local Government Pension Scheme is in scope of the investment consultancy requirements of the CMA Order but will not be in scope of them under the regulations (though a different Government department could legislate for this separately).

Differences between final regulations and the consultation draft

There are some differences between the final and consultation draft regulations (see WHiP Issue 77). Many of these align the regulations more closely with the CMA Order after respondents pointed out reasons not to change the current position. These and other key changes to the draft regulations are as follows:

- The definition of investment consultancy services, whilst still different from that in the CMA order, has been more closely aligned with it. It is also now clear that high level commentary on investment in an actuarial valuation report does not count.

- It is now clear that carrying out transition management services will not in itself amount to fiduciary management.
- Asset-backed contribution (ABC) arrangements are not intended to count as scheme assets when assessing whether the 20% fiduciary management threshold is met. (The same applies to buy-in policies and also did, expressly, in the consultation draft regulations.) The regulations could be clearer here: it purports to achieve these two exclusions not expressly but by including only "assets of the scheme which could be managed by a person who has a relevant delegated authority (irrespective of whether they are in fact so managed)". (The CMA order seemed to exclude neither, though its explanatory note suggested that it excluded both.)
- Eight schemes (including four master trusts) operated by sponsors who provide investment consultancy and/or fiduciary management services to their scheme (i.e. because that is part of their business) are out of scope of the CMA Order but will be in scope of the regulations' requirement to set investment objectives for investment consultants.
- 'OPS firms' (trustee-owned in-house investment managers) no longer have to be owned by the trustees of a single scheme in order to be outside the requirements. They can now be owned, directly or indirectly, by trustees of more than one scheme.
- Asset managers can now be in scope of the fiduciary management aspects of the regulations if they start to give advice at any time, not just in the first 12 months of their appointment.

Timings and reporting

Subject to Parliament's approval, the new regime should take effect from 1 October 2022 and the corresponding requirements of the CMA Order are expected to be revoked. Annual reporting will be via scheme returns to the Pensions Regulator – the regulations include details of the information that will be requested. This will hopefully replace the January 2023 CMA reporting requirement but the consultation response does not address this.

The Pensions Regulator will be updating its guidance in time for the legislation to come into force. Separate obligations to report breaches of the law to the Pensions Regulator may also apply.

Pensions dashboards

Pensions Regulator guidance

The Pensions Regulator has published guidance for trustees on their forthcoming pensions dashboards obligations, based on the indicative draft regulations published earlier this year (see WHiP Issue 94).

The guidance provides an overview and covers the following points:

- When your scheme needs to connect with dashboards
- Connecting to pensions dashboards
- Matching people with their pensions
- Information to provide to members
- Failing to comply with pensions dashboards duties
- Preparing to connect: checklist
- Staying in touch with developments

An accompanying press release warns trustees to start preparing for their deadline, citing research that indicates that a significant number of scheme records are not electronic and few affected schemes have started to digitise that data. The guidance says it could take at least 12 to 18 months to prepare. David Fairs is quoted as saying "We will take a dim view of trustees who carelessly fail to prioritise their dashboard responsibilities".

The guidance will be updated when the regulations are finalised and more Pensions Dashboards Standards have been published. Schemes will be contacted by the Regulator at least 12 months before their proposed connection deadline. Further information and support is promised from both the Regulator and the Pensions Dashboards Programme. The guidance lists the following expected future developments:

- Government response to the consultation on the draft Pensions Dashboards Regulations 2022 — expected summer 2022.
- Pensions Dashboards Programme (PDP) standards — to be consulted on in summer 2022.
- PDP guidance on early and voluntary connection — to be consulted on in summer 2022.
- Post-consultation Pensions Dashboards Regulations — expected autumn 2022.
- Department for Work and Pensions application process for scheme deferral of connection deadline — expected autumn 2022.
- Changes to the Financial Reporting Council's Actuarial Standards Technical Memorandum 1 (AS TM1) — the methodology used to calculate projected values in defined contribution pensions — consultation response expected in autumn 2022 with changes in force in October 2023.
- The Pensions Regulator compliance and enforcement policy for dashboards — to be consulted on in autumn 2022.

Separately, the PLSA has published a short checklist and summary of staging dates.

Please see our recent article '10 actions for getting to grips with pensions dashboards' for an outline of the proposed regime as it will affect occupational pension schemes, together with key action points for trustees.

Further Government consultation

The Government has published a new consultation, on when to make dashboards available to the public and on the sharing of information between the Money and Pensions Service (MaPS) and the Pensions Regulator. On the first point, it does not propose a date but suggests that 90 days' notice to schemes should be given, with no phasing-in (i.e. the dashboard will be accessible to all from the same date).

Data accuracy guidance

PASA's Data Working Group has published 'Dashboard Accuracy Data Guidance'. This short guide is designed to help schemes to improve their data accuracy. It includes information about the resources available for checking data against shared and public records.

GMP equalisation – interest on arrears

HMRC's Pension Schemes Newsletter 140 includes a section on the taxation of interest on GMP equalisation pension arrears. Much of this corresponds with an earlier announcement communicated by industry bodies (see WHiP Issue 95).

In summary, the newsletter says:

- Interest can be paid as a scheme administration member payment, and so as an authorised payment, where the rate is no more than a reasonable commercial rate. This includes where the rate is 1% above base rate (simple or compound) in line with the *Lloyds Banking Group* judgment or at a rate specified in the scheme rules.
- Such interest payments are taxable as interest under section 369 Income Tax (Trading and Other Income) Act 2005 in the year in which they are paid.
- It will often be the case that there is no obligation on trustees to deduct income tax at source (unless the payee usually lives outside the UK). But where the payment is made by a company (e.g. the employer) on its own account, there may be an obligation to do so. The rate is basic rate, not the individual's PAYE marginal rate. (The newsletter goes into more detail than this.)
- The interest qualifies as 'savings income', so the individual may not ultimately have to pay tax on it. This will depend on factors such as their total savings income and whether they are a basic or higher or additional rate taxpayer. Self-assessment tax returns should include the interest as savings income, so that the correct tax is paid. Those who do not complete tax returns should notify HMRC.
- As covered in the February 2020 GMP equalisation newsletter (see WHiP Issue 80), the arrears of pension are taxable under PAYE according to the individual's tax code and deductions must be made.

Note that there seems no reason why the same guidance would not also apply to interest paid in relation to any kind of late payment of pension scheme benefits, although the newsletter does not expressly confirm this.

GMP equalisation – past transfers-out

The GMP equalisation industry working group chaired by PASA has published guidance on the administration implications of dealing with past transfers-out. The guidance takes the form of a checklist, covering questions that require trustee consideration and addressing the administrative implications.

Stronger nudge

The Pensions Regulator has updated its 'Communicating and reporting: DC schemes' guidance to include details of how to make Pension Wise appointments in relation to the 'stronger nudge' requirements that took effect from 1 June 2022. Very broadly, these require trustees to push individuals who are looking to draw DC benefits or, if aged 50 or over, to transfer them for that purpose, to take Pension Wise guidance. See WHiP Issue 93 for more detail.

The Money Helper website now includes pages allowing Pension Wise appointments to be booked. There are separate pages for providers (which includes trustees) and individuals.

DC value for money

The Pensions Regulator and the FCA have published a feedback statement, following their recent discussion paper (see WHiP Issue 92), confirming that they will develop common measurements for comparing value for money in DC pension schemes.

The regulators will be considering factors such as investment performance, costs, charges, and service standards. This work is expected to lead to a consultation towards the end of the year.

DC decumulation call for evidence

The Government has published a call for evidence on helping DC pension scheme members to understand their decumulation choices. It is aimed at individuals, schemes and consumer organisations and seeks to explore what support members need to help them make informed decisions about how to use their savings.

In particular, the call for evidence:

- asks if Government legislation for occupational pension schemes should be more closely aligned with FCA rules for contract-based schemes, in particular the FCA requirements to send 'wake-up packs' earlier and more often, and structured 'investment pathways';
- includes a suggestion that Nest could be permitted to offer a wider range of decumulation options; and
- asks if commercial collective DC schemes could be used for offering flexible decumulation options, with an advantage being that members would not need to manage their investments through their retirement.

The call for evidence closes on 25 July 2022.

Separately, the PLSA has published a report: 'Retirement choices: the evolution of products and support'.

DC small pots

The DC small pots working group, which has been considering how best to address the proliferation of small pots has published an update report, in which it comments on its work to date and the steps that will be needed in order to make progress.

There are three potential solutions being taken forward:

> *"The **Pot Follows Member** model means that when an employee moves jobs, their deferred pension pot in their former employer's scheme automatically moves with them to the new employer's scheme, with the opportunity to opt out.*
>
> *Under the multiple **Default Consolidators** model, certain pots will automatically be transferred to a small pot consolidator, with savers being given an opportunity to opt out. If a person has multiple deferred small pots, these could be linked by the consolidator. This model comes with a variety of design choices. A single default consolidator model has been discounted, and should not be progressed further.*
>
> *The **Member Exchange** model, whose principles have been tested with three master trusts, identifies a small deferred pot in one master trust and an active pot in another master trust and merges the two into the active pot."*

The ultimate way forward might involve the use of more than one of these options.

Cybercrime protection

PASA's Cybercrime & Fraud Working Group has published a cybercrime protection checklist, aimed at helping administrators to combat cyber-attacks.

The working group previously issued guidance in November 2020, detailing information on cybercrime, how it has evolved over time and protection measures that can be taken. The new checklist gives examples of steps that administrators can take to assess their defences against cybercrime.

Collective DC

The Pensions Regulator has finalised its code of practice for the authorisation and supervision of collective money purchase schemes and has laid it before Parliament. It has also published a response to its January 2022 consultation (see WHiP Issue 94).

Under a collective money purchase scheme, also known as collective DC, 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.

Regulations were laid in March 2022 and take effect from 1 August 2022 (see WHiP Issue 94). Trustees will be able to apply for authorisation for their scheme from that date, for a substantial fee. Only schemes for single or associated employers will initially be permitted but consideration will be given by the Government to allowing commercial operators in future. Royal Mail is so far the only anticipated adopter of collective DC.

The Regulator has also published guidance on:

- How the authorisation fee will be set; and
- Identifying persons for the fit and proper assessment.

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