Briefing

The Pension Schemes Act 2021

A summary of the key clauses

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After prolonged and Brexit-delayed parliamentary debate, the Pension Schemes Bill 2019/21 finally received Royal Assent in February 2021, becoming the Pension Schemes Act 2021. Although most of the provisions are not yet in force, they are expected to come into effect over the course of the next year, once secondary legislation has been passed.

In the meantime, Guy Opperman, the Parliamentary Under-Secretary of State for Pensions and Financial Inclusion, has confirmed that changes to The Pensions Regulator's (TPR's) powers will not apply retrospectively – saying the new criminal sanctions and information gathering powers will "apply to all schemes where the act occurs" from autumn 2021 onwards.

In follow-up, TPR has since published a draft of its "criminal sanctions policy" on how it intends to approach investigation and prosecution under the new powers conferred by the Act.

Further consultations are also expected over the next year in relation to other clauses in the legislation, including the key provisions relating to the below.

- Measures to **enhance TPR's powers** to protect DB schemes in relation to corporate transactions
- Establishing a new **Scheme funding regime**, introducing a requirement for schemes to have a "funding and investment strategy" and to report on to TPR in a "statement of strategy"
- The creation of **pensions dashboards**
- The establishment of **Collective Money Purchase schemes** (aka Collective Defined Contribution schemes)
- Requiring pension schemes to report on how they manage the **financial risks of climate change**
- Tightening the conditions for paying **statutory transfer values** to protect members from scams

TPR's powers

Since the publication of the pensions Green Paper in 2018, TPR's powers have evolved to reflect perceived shortcomings, highlighted in a number of recent high profile corporate insolvencies. The Pension Schemes Act therefore establishes:

- New grounds for TPR to issue Contribution Notices based on an insolvency test or a resourcing test.
    - Under the insolvency test, TPR will consider whether an action by the employer or connected party means the amount which could be recovered on serving a 'section 75' debt has been materially reduced
    - Under the resourcing test, TPR will consider whether an action materially reduces the value of an employer's resources relative to the size of the scheme
- New criminal offences punishable with significant fines and up to seven years' imprisonment. These offences include failure to comply with a Contribution Notice, deliberately avoiding a Section 75 debt and engaging in "conduct risking accrued scheme benefits"

    These new offences are punishable by potentially unlimited fines and prison sentences of up to seven years.

    In mitigation, however, the Pensions Minister has said that it is not the intention of the new laws to "frustrate legitimate business activities" and that the punishments will only be applied where the person taking them "did not have a reasonable excuse".

    Since the Act received Royal Assent, TPR has been consulting on a draft of its "criminal sanctions policy" setting out how it will use its new powers. TPR has said that "the intent of the new criminal offences is not to change commercial norms or accepted standards of corporate behaviour. Rather, it is to tackle the more serious examples of intentional or reckless conduct that puts members' savings at risk". In particular, TPR will be on the look-out for:

    - unfair treatment of the pension scheme, or where TPR and / or the pension scheme trustees have somehow been misled;
    - conduct where the main purpose is to abandon the DB scheme without some form of mitigation in lieu; and
    - situations where material financial gain has been made at the expense of security for the scheme.
- New information-gathering powers for TPR and an updated Notifiable Events framework with associated financial penalties of up to £1m for failure to comply. With these new powers, TPR will be able to enter a "wider range of premises [to obtain documents] and require individuals to attend an interview"; and
- Enhanced oversight for TPR, which will require relevant parties to submit information about corporate transactions, including how any detriment to a Defined Benefit (DB) pension scheme is to be mitigated. These so-called "declarations of intent" will likely be required where there is a change in controlling interest or a sale of "a material proportion" of an employer that is responsible for at least 20% of a scheme's liabilities, or where security is granted on a debt that will rank higher than the scheme.

    It is expected that these statements will have to be submitted before any transaction completes, although the finer details will be set out in secondary legislation.

The relevant sections of the Act are expected to come into force in at the start of October 2021. In the meantime, TPR has published a draft policy on its approach to the investigation and prosecution of the new criminal offences.

Scheme funding

The Pension Schemes Act 2021 imposes a new duty on DB scheme trustees to establish a formal funding and investment strategy for the longer-term.

The trustees' strategy document will have to set out the funding level which the trustees intend the scheme to have achieved, and detail the investments the trustees intend the scheme will hold, at specific dates in the future.

> TPR will have the power to direct trustees to revisit their strategy if it is not compliant with the legislation.

At each funding valuation, the assessment of the scheme's "technical provisions" (i.e. valuation liabilities) are then expected to be assessed consistently with the trustees' 'journey plan' towards their long-term strategy. The long-term aim for most schemes is expected to incorporate a decreasing reliance on the employer covenant.

The trustees will set out their strategy in a written document to be agreed with the sponsoring employers, and which will need to include information about the below.

- The extent to which their funding strategy has been implemented
- The key risks inherent in the strategy and how they will be managed or mitigated
- What steps have been taken to rectify shortfalls
- Information regarding key funding and investment decisions taken.

The Department for Work and Pensions (DWP) is expected to consult on the necessary secondary regulations, including further detail on the contents of funding strategy statements during 2021. The regulations will also set out further details which may have to be incorporated into funding strategies.

The key principles for regulating the new funding regime were set out in a consultation published by TPR in March 2020, including the following.

- A fast-track regime for demonstrating compliance if a scheme's funding approach is within specified parameters. If using this approach, trustees can expect much less scrutiny from TPR.
- However, trustees and employers may still agree 'bespoke' funding approaches specific to their scheme's circumstances.

TPR's second consultation on the content of the new scheme funding code of practice will follow towards the end of 2021, with the new code expected to come into force in late 2022.

Pensions Dashboards

The Act paves the way for the establishment of Pensions Dashboards allowing the public to access online information about their pension arrangements, including their state pension entitlement.

> Pension scheme trustees and providers will be expected to supply the required data, and the Act establishes a legislative framework for the services to be offered.

Most of the detail for the operation of dashboards will be contained in secondary regulations. Initially, The Money and Pensions Service (MaPS) will operate the only pensions dashboard, with commercial offerings being established shortly after, provided certain qualifying criteria are met.

Regulations will require trustees to comply with requests for the provision of certain specified information to the dashboards, and in a specified format.

Pension scheme trustees are likely to be required to provide information relating to the below.

- The types of benefits offered and the way in which the scheme is operated
- Individual members' benefit entitlements and
- The scheme's financial position and contact details

In the meantime, MaPS and the Pensions Dashboard Programme (PDP) has published a series of consultations on the expected timescales and a guide to data standards.

The Government is expected to consult on the necessary secondary legislation in due course, with a view to it coming into effect in 2022 – and for the initial data collections to start in 2023.

Collective money purchase schemes

The Pension Schemes Act creates a new framework for establishing and administering 'collective money purchase' (CMP) pension schemes (previously referred to as Collective Defined Contribution (CDC) schemes).

CMP schemes will operate in a similar way to defined contribution (DC) schemes. However, instead of individual members having their own "pot" of savings, member and employer contributions go into a collective fund. The investment and longevity risks are then shared by the membership as a whole rather than being borne by individual members or the employer.

On retirement, members' pensions are then based on their share of the collective fund and, while the CMP scheme will target a certain level of pension for members, this will not be guaranteed and the value of a member's pension could go up or down.

Under the Act, CMP schemes will have to be authorised and supervised by TPR (as other occupational schemes and master trusts currently are) – and the regulations containing all the necessary details are expected to be set out in a consultation this summer. These regulations will establish what actuarial approaches can be used to calculate members' benefits.

The Act also establishes that CMP schemes will be restricted to a single sponsoring employer or a number of connected employers – at least initially.

Climate change

Clauses in the Pension Schemes Act give Parliament the power to make secondary regulations which will eventually require trustees to ensure they have governance arrangements in place in relation to the effects of climate change. In particular, trustees will be required to report information in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

Regulations have already been consulted on which will require trustees of occupational pension schemes that are in scope to meet the climate change governance requirements underpinning the eleven recommendations of the TCFD, and to report on how they have done so.

These regulations will come into effect on 1 October 2021 for master trusts and the largest occupational pension schemes (at least £5 billion assets). Schemes with assets over £1 billion will comply from October 2022. The Government will consult again in 2023 on bringing smaller schemes into scope – possibly from 2024.

Schemes' reports on TCFD compliance will have to be produced within seven months of each scheme year-end.

The Government has also published non-statutory statutory guidance to accompany the regulations and to help trustees meet their reporting obligations. The guidance suggests trustees consider three core duties when making investment decisions:

1. Ensure that investment powers are exercised for their proper purposes, with climate-related risks and opportunities considered within this context.
2. Take account of material financial factors – and consider the financial implications of "transition risks" and "physical risks"
3. Act in accordance with the "prudent person" principle – and note in particular that what might be considered prudent in relation to climate risks today, may no longer meet that standard in future.

Transfers – protection for members

To help in the battle to protect members from pension scams, the Act puts a restriction on transfer rights, which may not be exercised unless additional restrictions (to be set out in regulations) are complied with. The required regulations are expected to be issued in draft form later this year.

In particular, a member may need to demonstrate an employment link in relation to an occupational pension scheme to which they wish to take a transfer. Members' statutory right to a transfer can be rescinded if no such employment link can be established.

In the meantime, trustees should continue to be alert to the warning signs that a transfer might need to be halted - including members being unduly pressured to transfer, a lack of advice from a suitably qualified person or the receiving arrangement not being regulated by the FCA or TPR. In future, legislation may require members to obtain formal guidance if such a warning sign is present.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch via the following:

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