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BULLETIN

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PENSIONS BULLETIN

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In this month's Pensions Bulletin, we look at new guidance for employers and trustees on helping employees with pension options without the risk of contravening financial services legislation. We cover two ESG developments – the new climate change strategy from the Pensions Regulator (TPR) and the Government's consultation on considering social risks. There is an update on the latest developments on pension scams. We consider new guidance from TPR on its approach to settlement of regulatory or civil enforcement action and a policy change from TPR on cross-border schemes and auto-enrolment. The final item is a report of a further successful court application to rectify pension scheme rules.

GUIDANCE ON HELPING EMPLOYEES AND MEMBERS WITH FINANCIAL MATTERS

The updated guide issued jointly by the Financial Conduct Authority (FCA) and TPR intends to provide better guidance to employers and trustees that want to engage with employees about pension options without contravening financial services legislation. Whilst the guidance is more detailed, and contains more practical guidance and examples, it is not clear that it will achieve its stated aims. There remain areas of uncertainty, and so (without legislative change) some employers and trustees may not be willing to risk being penalised for trying to do the right thing.

The FCA/TPR Guide covers various areas where employers and trustees might be at risk of needing to be authorised by the FCA because they are carrying out the business of "arranging transactions", providing regulated advice or providing material promoting a particular financial product ("financial promotion"). (Auto-enrolment is an exception to the financial promotion rule, as is giving information about other financial workplace benefits such as employee share schemes.) In most cases, as employers and trustees are not receiving any commercial benefit, they should not need authorisation. However, to be on the safe side, they should avoid anything that could be construed as arranging or advising. The Guide advises that, to avoid the need for authorisation:

- Employers and trustees should not answer specific questions from employees or members which require an understanding of the individual's financial circumstances (such as which investment fund to choose, or whether they should transfer in benefits from a previous pension scheme).

- Information on retirement options should be generic (for example, explaining the difference between drawdown and annuities, or providing information on life expectancies to help members understand how long their retirement might last) and avoid steering members to a specific product. Trustees should not give members illustrative figures that compare the outcomes they might get if they kept a DB benefit or transferred or converted it into flexible benefits, or information about future drawdown (which depends on assumptions rather than facts). Only factual information generally available to the public, such as the level of an equivalent immediate annuity, should be used. Alternatively, signposting to publicly available resources such as the Money and Pensions Service is allowed.

- Introducing members to independent financial advice (IFA) firms does not need authorisation. The FCA/TPR accept that employers and trustees may be in a better position than employees or members to identify a suitable firm and to negotiate good terms. Alternatively, some trustees may see value in appointing independent third party experts to recommend a firm and to undertake ongoing review of the quality of the advice service provided. They can do this as long as they take care not to give advice or arrange transactions. However, it may be harder for a "restricted" advice firm (offering advice on a limited selection of financial products only) to satisfy the requirement to give independent advice. The Guide encourages employers or trustees, concerned that they are at risk of giving advice or arranging transactions, to take legal advice.

- Separately, the Pensions Ombudsman (TPO) has recently issued a factsheet on Panels and Independent Financial Advisers, urging schemes to ensure that their selection of IFAs is demonstrably impartial and to carry out due diligence in preparing the list (checking an IFA's status with the FCA, for example). Trustees or administrators should also make clear they are merely facilitating access to advice and that any legal relationship is solely between the member and the IFA. TPO points out that, in the event that a member is given poor financial advice, the individual may look to make a complaint not only against the IFA but also against the trustees/administrators, by means of a maladministration complaint to TPO.

- If employers contribute to the cost of advice, taking advantage of the income tax exemption for employer-arranged pensions advice, it is good practice to make employees aware that HMRC treats advice costs over a certain amount (currently £500 in a tax year) as a benefit in kind.

Following consultation last year, the FCA has also finalised its guidance for financial advisers - *Advising on pension transfers* - on giving advice on transfers from DB schemes and this has been published at the same time as the FCA/TPR Guide. Although addressed to financial services firms, it also contains a template on which the FCA and TPR have collaborated with the Pensions Administration Standards Association (PASA) to agree a set of information about the ceding scheme. This includes details of the scheme and its funding, member details, the transfer value, early and late retirement factors and retirement benefits. Although the guidance describes this as information that firms should collect before giving advice, the FCA adds that schemes should provide this information automatically with a transfer quotation.

Next steps for employers and trustees: Consider whether any communications currently provided to employees come within the scope of the guidance issued by FCA/TPR and TPO and, if so, whether any changes or clarifications are required. Check that the information listed in the FCA/PASA template is being supplied with transfer quotations.

THE PENSIONS REGULATOR'S CLIMATE CHANGE STRATEGY

TPR has published its Climate change strategy. There is a clear warning for trustees that TPR will consider taking enforcement action on failure to comply with disclosure duties and obligations under the Pension Schemes Act 2021.

In January, the Government published its response to consultation on proposals to require large schemes to manage climate risks and opportunities and report in line with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). Our February 2021 detailed client briefing: Climate risk and the Pension Schemes Act covers what trustees will need to do and the wider impact of the new governance and disclosure regime. TPR has recently made clear the importance that it attaches to pension trustees addressing climate risks, pointing out that the new regime is likely to increase engagement by members with their schemes on climate risk. To follow this up, TPR has set out its objectives in a Climate change strategy, including:

- Schemes should publish their Statement of Investment Principles (SIP), implementation statement and, if in scope, disclose their TCFD report. Where they do not, and it is appropriate to do so, TPR will take enforcement action, which it may publicise. TPR will also publish a review of implementation statements on stewardship and engagement activities.
- TPR will publish guidance for trustees to accompany the Regulations under the Pension Schemes Act 2021 on climate risk, due to come into force in October 2021. TPR may take enforcement action against those not meeting legal duties. TPR regards the integration of covenant, actuarial and investment risk as key and the guidance will consider how to take account of the impact of climate change in Integrated Risk Management. When the Regulations are reviewed in 2023, TPR will produce best practice TCFD reports, in conjunction with the DWP.
- TPR will encourage those who run pension schemes to comply with legislation and take account of TPR guidance.
- Modules on climate change and stewardship will be added to the new consolidated Code of Practice for pension schemes published last month and there will be updated content in the Trustee Toolkit.
- TPR will review scheme reports on scenario analysis to assess resilience to climate-related scenarios.
- TPR confirms that it will be adding questions on web addresses of the SIP, implementation statement and TCFD report to the scheme return.

Next steps for trustees: If the scheme will be in scope for the Pension Schemes Act 2021 climate risk requirements, start preparing a plan for compliance.

GOVERNMENT CONSULTATION ON CONSIDERING SOCIAL RISKS

To date the focus has been on climate-related risks. However, the Government has now issued a consultation on schemes' consideration of social risks and opportunities. The consultation includes a detailed analysis of the meaning of "social factors" (with links to resources) and discusses the circumstances in which they can be financially material. Trustees will need to take this into account along with the wider discussions on ESG. The consultation also covers stewardship – the DWP is clearly not happy that trustees are saying there is little they can do if they invest in passive or managed funds and is encouraging trustees to hold managers to account.

On 24 March 2021, the DWP launched a consultation on consideration of social risks and opportunities by pension schemes, asking for views to be submitted by 16 June 2021. The motivation for this is a recent DWP survey of the ESG and stewardship policies and practices of 40 of the largest pension schemes, which revealed that performance was "mixed". As a result, the Government says it is seeking to understand whether it needs to do anything "*to ensure trustees are better able to meet their legal obligations*". Examples of social factors include:

- Practices within a company or its supply chain (raising issues such as modern slavery, health and safety and employee engagement).
- Company products and selling practices (such as product safety and customer privacy).
- Companies in the community (covering topics such as human rights and use of local workforces).

It also points out that ESG factors are often interconnected; for example, the transition to a lower-carbon economy entails social considerations such as the impact on communities and fair working conditions.

The paper sets out the trustees' current legal duties on financially material social factors - such as the requirement to have a Statement of Investment Principles (SIP) and implementation statement. It explains that, by contrast, trustees are not required to take account of non-financial matters when making investment decisions, although trustees of schemes required to have a SIP must set out their policy on the extent to which, if at all, they take into account non-financial matters. Here the DWP adds that this "*may include wider considerations relevant to members' and beneficiaries' views on non-financially material social factors*", without providing any indication about how trustees go about taking into account these wider considerations. To compound this, DWP also comments that ESG factors do not neatly divide between financial and non-financial. Some factors may be financially material considerations in relation to certain investments at certain times, whilst at other times they are not financially material. For example, this may be the case when regulatory reform in respect of a certain business practice appears more or less likely to happen.

The paper sets out ways in which trustees can take social factors into account:

- Screening (exclusion) – to avoid investments in assets associated with poor performance on social factors (such as controversial weapons).
- Tilted funds – the portfolio's exposure is tilted to companies performing well on social "scores", or away from lower scoring ESG assets or sectors that have performed poorly on social issues.
- Social impact investing - investments made with the intention of generating a positive social impact alongside the financial return. DWP notes that trustees should only do this if it is compatible with their fiduciary duty to act in the best financial interests of scheme beneficiaries.
- Voting - in a way that supports social considerations, either directly or via an asset manager.
- Engagement with companies on social issues, either directly or via an asset manager.

On stewardship, the DWP emphasises that this is not a box-ticking exercise and trustees need to be willing to have a "meaningful dialogue" with management. Although many trustees invest passively and in pooled funds, trustees can still take account of social factors through their choice of fund and asset manager and through conversations with managers. The Government is considering the possibility of requiring trustees to explain how their stewardship policies and activities are in members' best interests.

Next steps for trustees: Check that current obligations on ESG policy disclosure and stewardship are being followed and documented correctly.

LATEST DEVELOPMENTS ON PENSION SCAMS

A revised version of the Industry Group Code of Good Practice on combating pension scams has been published. Although this has not yet been put on a statutory footing, as mooted in a recent TPR podcast, the Code is referred to frequently by the Pensions Ombudsman in its decisions on maladministration in transfers. Meanwhile, the Parliamentary Select Committee report on pension scams is critical of current measures to tackle fraud.

On 1 April 2021, the Pension Scams Industry Group (PSIG) announced the launch of an updated version of its Code on combating pension scams: Version 2.2 of Combating Pension Scams - A Code of Good Practice. The Code has no statutory basis but it points out that TPR expects trustees to carry out a reasonable level of due diligence on transfer and cash withdrawal requests and that the Code represents good industry practice on due diligence. The Code includes a Practitioner Guide (setting out due diligence steps for schemes when assessing transfer request scam risks), a Resource Pack with example scripts, letter and discharge form wording, as well as a Technical Guide of legislative and regulatory requirements. The main changes since the previous version was issued in June 2019 are:

- Trustees should consider engaging with the member by telephone during the due diligence process and a final telephone call to the member should precede the making of a transfer payment in circumstances where pension scamming concerns have been identified. This mirrors the requirements outlined in TPR's Combat Scams pledge (see our Pensions Bulletin November 2020).
- All transfers of concern should be reported (not just those transfers which are refused). Reports should be made to a number of different agencies as required; full information is provided in the Practitioner Guide.
- Management information should be developed, including details of transfers refused, cancelled by the member when concerns have been raised with them and transfers paid under discharge at the member's insistence.

The Parliamentary Work and Pensions Select Committee (WPSC) has published its report on a call for evidence on pension scams following on from the 2015 pension freedoms. The WPSC is asking Government to take action, including new legislation in the Online Safety Bill relating to online investment fraud. The report calls for the Project Bloom multi-agency task force tackling pension fraud to be strengthened and put on a statutory basis. The report criticises the fragmentation of reporting, investigation and enforcement of pension scams. There is also criticism of HMRC's "lack of empathy" when pursuing scam victims and a recommendation that when people access a defined contribution pension pot before age 55, the income tax and surcharge due should be paid to HMRC before they receive the balance.

In the light of the proliferation of pension scams identified in the WPSC report, the new pre-conditions for cash equivalent transfer values, to be set out in regulations under the Pension Schemes Act 2021, should be of assistance. Consultation on draft regulations is expected "early summer" 2021 with commencement "from early autumn". This should help trustees in scenarios similar to a recent Pensions Ombudsman case. In *Mr Y*, the Pensions Ombudsman found that a scheme's refusal to make a transfer to an overseas pension scheme, because the transferring scheme trustee could not be satisfied that the receiving scheme was a Qualifying Recognised Overseas Pension Scheme (QROPS), was maladministration. The absence of an HMRC guarantee that the receiving scheme was a QROPS did not justify the refusal to transfer. Although HMRC's inability to provide a guarantee added a greater degree of uncertainty to the trustee's deliberations, this could not be used to negate the member's right to transfer under overriding legislation. The Ombudsman directed the trustee to reconsider the transfer and pay £1,000 for serious distress and inconvenience.

Next steps for trustees: Check compliance with the new version of the scams Code.

THE PENSION REGULATOR'S SETTLEMENT POLICY

TPR has published a Settlement Policy, setting out the approach it will take when negotiating settlement of regulatory or civil enforcement action. The policy makes it clear that TPR will consider settlement of a case at any stage. The policy will be of significance for parties involved in corporate transactions to which TPR's powers might apply.

TPR's Settlement Policy applies to settlement of regulatory or civil enforcement action. TPR is not bound by the policy and it does not apply to criminal sanctions, clearance or the specified period following the issue of a Financial Support Direction within which reasonable financial support should be put in place.

In exercising discretion to settle, as well as taking into account the circumstances of the case, TPR will also balance the protection of members and the Pension Protection Fund (PPF) against the costs of enforcement and strength of TPR's case. Other factors include the duration and costs of regulatory action, the ongoing sustainability of the solution and behavioural change; the outcome should aim to increase compliance generally. The terms of TPR's policies, guidance and other materials will also be relevant. In arriving at a settlement, TPR will decide what a "*fair and appropriate outcome*" is.

The policy includes examples of settlement options, such as payment of a cash sum or other assets, security over assets, changes to the sponsoring employer, "Section 75" guarantees and dividend sharing arrangements.

Settlement discussions can be started by the TPR or the potential target of enforcement action. TPR may involve other interested parties (such as trustees, employer, the PPF and HMRC). Where the target declines to include other parties, TPR may decide not to proceed with settlement discussions. TPR will usually continue the investigation or proceedings in parallel with any settlement discussions.

UPDATED CROSS-BORDER SCHEMES GUIDANCE ON AUTO-ENROLMENT DUTIES

In a change to its guidance on Cross-border occupational pension schemes: arrangements following the end of the Brexit transition period, the Pensions Regulator (TPR) has warned that cross-border schemes may no longer be valid vehicles for the automatic enrolment of eligible jobholders in accordance with duties under the Pensions Act 2008. Therefore, if employers were using an EU/EEA based scheme as an automatic enrolment scheme at the end of the Brexit transition period, immediate automatic re-enrolment will have been triggered on 1 January 2021 and they will need to automatically re-enrol any affected jobholders into an alternative automatic enrolment scheme.

On 31 March 2021, TPR updated its guidance on *Cross-border occupational pension schemes: arrangements following the end of the Brexit transition period*. TPR's guidance issued in February 2021 (see our Pensions Bulletin March 2021) said that if a cross-border scheme met the non-UK qualifying criteria and the additional requirements to be an automatic enrolment scheme during the Brexit transition period, then the scheme could continue to be used as an auto-enrolment vehicle from 1 January 2021. By contrast, the 31 March 2021 version says that the rules for using EU/EEA based schemes to meet auto-enrolment duties changed on 1 January 2021 and it is no longer possible for an employer to use a non-UK scheme (including an EU/EEA scheme) as an automatic enrolment scheme. (An automatic enrolment scheme is defined in the Pensions Act 2008 as a "qualifying scheme" which meets certain additional requirements.)

Therefore, if employers were using an EU/EEA based scheme as an automatic enrolment scheme at the end of the Brexit transition period, immediate automatic re-enrolment (as opposed to cyclical re-enrolment) will have been triggered on 1 January 2021. If employers are using a non-UK automatic enrolment scheme, they should take urgent steps to automatically re-enrol any affected jobholders into an alternative automatic enrolment scheme.

If an employer's EU/EEA or other non-UK scheme was a qualifying scheme at the end of the Brexit transition period, the employer may be able to continue using the scheme. However, even if they continue using a non-UK qualifying scheme, they will also need to have an automatic enrolment scheme in place for any new joiners who meet the auto-enrolment criteria.

Next steps for employers and trustees: If using a non-UK automatic enrolment scheme, ensure that any affected jobholders are automatically re-enrolled into an alternative scheme.

RECTIFICATION TO CORRECT PENSION INCREASE RULE

The High Court has sanctioned rectification of a defined benefit scheme deed and rules that accidentally omitted an important part of the pension increase rule. As with the recent Univar case, the decision illustrates a judicial willingness to agree to rectify drafting errors in pension scheme documentation. On a practical level it again highlights the importance of both trustees and sponsors agreeing to a schedule of changes as evidence as to what was intended in the drafting of any amending deed.

Iggesund Paperboard (Workington) v Messenger concerned the unintended omission of words in the pension increase rule of the 2004 version of the scheme rules. In the 2004 version, the rule provided for increases to be "*the lesser of five per cent or ... the same percentage (if positive) as the percentage increase (if any) in the Retail Prices Index [RPI]*". Rules in the previous (1992) version provided for an index other than RPI to be applied by including, after the reference to RPI, the words "*or such other index as the actuary advises to be appropriate*". The trustee and principal employer applied to the Court for rectification of the 2004 rules to include those words.

The update of the 1992 rules began in 1996, following the Pensions Act 1995. According to the trustees, the purpose was principally to produce an updating draft, leaving the rules in essentially the same form. The drafting style used to show that text had been omitted from the original deed was by means of a mark without showing the original text. There was a mark showing that the actuary advice provision had been omitted, but the omitted text was not shown. However, a marked-up draft made by a trustee director recorded the words "*same as old 25.1*". The omission was not discovered until 2017.

The application for rectification was granted. The High Court said it was an example of an unintended error in a complex legal document where words that were in the underlying document and were intended to remain in place disappeared at some point in the drafting process without anyone noticing. The evidence confirmed that neither the trustee, nor the employer, had intended the deletion to be made. The Judge described it as "*the clearest possible case for rectification*".

The High Court relied on the decision in *Univar UK Ltd v Smith,* where the High Court granted rectification in a case involving the inadvertent hardwiring of RPI into a scheme's pension increase rules (see our Pensions Bulletin July 2020).

The Court application was not opposed by the members as a body. However, the trustee had consulted on the proposed amendment to the rule. (Whilst not a requirement, the Court commented that this was "*recognised as being good practice*"). In their consultation response, two scheme members indicated that an increase in RPI was a major factor in their decision to draw their retirement pension and that they might have made a different decision had they been aware of the proposed amendment. The Court noted that the appropriate place to pursue this would be to the Pensions Ombudsman but that, even if the members could argue that the trustees were estopped from making the amendment, there was no evidence of the necessary reliance by, or detriment to, the two members.

Next steps for employers and trustees: Agree to a schedule of changes in relation to the drafting of any amending deed.

PENSION LEGISLATION AND REGULATION WATCH LIST

No	Topic	Deadline	Further information/action
1	Statement of Investment Principles (SIP) annual implementation statement	Annual reports which are signed off on or after 1 October 2020	This applies to all pension schemes required to provide a SIP. The requirements for DB schemes are more limited: they do not require a review of the SIP; and limit the provision of details of how the SIP has been followed to voting and engagement only.
2	Include annual implementation statement on website	Annual reports which are signed off on or after 1 October 2020	For DC schemes only. (The requirement for DB schemes applies in part only, and later - see 7 below.)
3	Draft DB Funding Code of Practice	Regulations expected for consultation "later" in 2021 Part 2 of consultation on draft Code expected "later in" or "towards end" of 2021 and new Code expected to be operational in late 2022/early 2023.	Once in force, the Code will apply to triennial valuations thereafter.
4	Pensions Schemes Act: TPR powers; scheme funding; CDCs; transfer scams; pension dashboards	Different implementation dates expected for different parts	Regulations and further consultation expected. Climate risk provisions - see 8 below.
5	TPR consolidated Code of Practice		TPR consultation issued 17 March 2021 and closes 26 May 2021
6	Trustee oversight of fiduciary managers and investment consultants	Under the Investment Consultancy and Fiduciary Management Market Investigation Order 2019, compliance statements, confirming the extent to which requirements have been met, had to be provided to CMA by 7 January 2021.	Consultation response and new DWP regulations have been delayed until June 2022.

No	Topic	Deadline	Further information/action
7	Include annual statement on compliance with policy on stewardship and engagement activities, and voting behaviour, on website	1 October 2021	DB schemes only.
8	Climate risk governance and reporting requirements under the Pension Schemes Act	1 October 2021	Applies to schemes (DB and DC) with £5 billion or more in net assets on the first scheme year to end on or after 1 March 2020. They will be required to have governance for the scheme year underway from 1 October 2021 and publish the first annual report within seven months of the end of the scheme year. Consultation on draft Regulations under the Pension Schemes Act and draft statutory guidance issued with response to consultation.
9	Proposals to improve DC scheme governance and disclosure and to encourage consolidation, including changes to the annual Chair's statement and charge cap changes	October 2021	DC schemes only. Response to March 2021 consultation and remaining parts of 2020 consultation, together with final statutory guidance and final regulations, expected June 2021.
10	DB superfunds	Interim regulatory regime in place from October 2020	New legislation promised.

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