

## PENSIONS BULLETIN

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In this month's Pensions Bulletin, we examine the Government's finalised proposal for the new "employer resources" test which if failed gives the Pensions Regulator (TPR) discretion to issue a Contribution Notice. We also look at TPR's guidance and enforcement policy on the new climate change governance and reporting regulations. We review the proposed new requirement for trustees to refer members to guidance before accessing flexible benefits. The final item is on PASA's conversion guidance on GMP equalisation. Our watch list is included at the end of the Bulletin.

### THE NEW EMPLOYER RESOURCES CONTRIBUTION NOTICE TEST

*Before taking material corporate action, consideration needs to be given (from 1 October 2021) to three tests in Section 38 of the Pensions Act 2004 which if not passed could lead to personal liability for directors. The Department for Work and Pensions (DWP) has now confirmed that there will no change to the proposed "normalised profits before tax" test to value a material reduction on employer resources. This is in spite of responses to consultation. The concern is that, for example, the sale of an asset by a statutory employer will result in a reduction in profitability material to the Section 75 solvency deficit and TPR's Determinations Panel could, if it considers it reasonable, issue a Contribution Notice (CN).*

In addition to the corporate considering (often with its own independent employer covenant advice) the long-standing general "material detriment" test in Sections 38 and 38B of the Pensions Act 2004, consideration now needs to be given to the two new post-1 October 2021 tests for a CN in Sections 38C to F, introduced by the Pension Schemes Act 2021 (PSA):

- the "employer insolvency" test, and
- the "employer resources" test.

Under the employer resources test, TPR can issue a CN on a person where, in TPR's opinion:

- that person was party to an act/failure to act which reduced the value of the "resources" of the employer; and
- the reduction was "material" relative to the estimated Section 75 debt in relation to the scheme.

A statutory defence can be established for both new tests (which may well be preferable to seeking "clearance"). TPR must be of the opinion that it was reasonable to impose a CN. For more detail on the new tests, please see our [client bulletin](#) on the PSA and our [Pensions Bulletin March 2021](#).

Earlier this year, the DWP consulted on draft regulations under the PSA, outlining a proposed approach to what constitutes "employer resources". The test is based on

profitability so “resources” of the employer will be measured only by the employer’s normalised profits before tax and not, as had originally been expected, a net assets test (as for Financial Support Directions). The DWP has now published its [response](#) to consultation, confirming that it will go ahead with its proposals. The updated draft regulations are intended to come into force on 1 October 2021.

Key points to emerge from the Government’s consultation response are:

- There is no change to the consultation proposal to measure employer resources by reference to the employer’s normal annualised profits before tax (NAPBT): the key aspect of the test is capturing the impact of the act, and the DWP remains of the view that NAPBT gives the most appropriate picture of net profits available to provide support for the scheme. Non-recurring and exceptional items (as determined by TPR) are to be excluded: TPR must have regard to financial reporting standards when deciding this. Provided TPR takes into account all relevant information in its possession when completing its employer resources calculations, no further verification is required.
- The new regulations will clarify the position on retrospectivity of the new CN powers - that the new tests will apply to acts or failures to act from 1 October 2021. The Commencement Order for the new regulations will confirm this position.
- TPR will assess each of the four CN tests in isolation: the response notes that this approach should meet concerns that the NAPBT measure will not catch certain acts.
- Meeting the employer resources test will not automatically mean that a CN will be issued - TPR must consider it reasonable to impose a CN. The response confirms that this separate reasonableness test may include a broader assessment of the employer’s strength than that contained in the employer resources test itself. An example from the consultation paper was that if an employer’s profitability has reduced as a result of an act, the employer might nevertheless continue to have sufficient strength to support the scheme - for example, due to its assets, which would not be taken into account in a profitability assessment.
- TPR case workers are confident that there is sufficient flexibility to be able to deal with any additional requests for clearance. TPR is considering whether there is a need to provide guidance in relation to the new tests and its CN powers generally. It is also considering whether to produce a single document pulling together its experience of using its CN powers over the last 15 years.

The consultation also covered the extension in the PSA to TPR’s **information gathering powers**. On interview notices, the effect of the regulations is to require TPR to set out very clearly in the notice who is being required to attend, the type of interview, and why the person is being interviewed. For criminal investigations, the notice will additionally state whether the person is being called as a suspect or a witness. TPR would normally expect to give not less than 10 working days’ notice of an interview.

**Next steps for employers:** Before entering into material corporate activity, consideration should be given at the outset to taking employer covenant advice on the three specific tests in Section 38 so that a statutory defence can be established. The employer resources test will involve considering whether the profitability reduction is material relative to the Section 75 solvency shortfall. There is scope here to consider that the reference to materiality invites a contextual judgement. If the statutory defence in Section 38 is not established by following the prescribed process (or formal clearance is not obtained from TPR’s office) there remains the risk, if TPR’s office does later pursue the event (within six years of the event), that a Determinations Panel may, if it considers reasonable, impose a CN on individuals as well as corporates.

## CLIMATE CHANGE GOVERNANCE AND REPORTING: TPR GUIDANCE AND ENFORCEMENT POLICY

*The draft guidance indicates factors TPR is likely to take into account in assessing whether trustees have met the requirements of the Climate Change Governance and Reporting Regulations. It should be read alongside the statutory DWP guidance. This is most pressing for the largest of schemes (including DC master trusts) that become subject to the new requirements on 1 October 2021.*

TPR has announced a [consultation](#) (running until the end of August) on draft guidance, and a draft appendix to its Monetary Penalties Policy, relating to enforcement of trustees' duties under the Climate Change Governance and Reporting Regulations and statutory guidance. The Regulations and statutory guidance were finalised in June 2021 and discussed in our [Pensions Bulletin June 2021](#). The draft TPR guidance does not contain the full picture on trustees' climate risk duties - further guidance is to be issued (TPR does not say when) on sponsor covenant assessments.

The draft guidance - [Governance and reporting of climate-related risks and opportunities](#) - states that TPR will be "looking for clear evidence" that trustees:

- are taking proper account of climate change when making decisions about the scheme, and that advisers are helping to do this;
- have carried out analysis consistent with the Task Force on Climate-related Disclosure (TCFD) recommendations;
- have seriously considered climate change risks and opportunities, in the scheme's particular circumstances; and
- have decided what to do as a result of the analysis and set a target to help achieve it.

Separate sections of the guidance each contain "example steps to take" (summarised below) and a list of what should be in the TCFD report. There are links to corresponding sections of the statutory guidance. Most of TPR's draft guidance refers to what trustees "should do" - if trustees take a different approach they should say why in their TCFD report. However, there are also mentions of what trustees "must" do, in order to avoid possible enforcement action, and the list of contents of the TCFD is divided clearly into matters the trustees "must" and "should" describe.

#### **Governance - steps to take**

- Include climate-related risks and opportunities in decision-making, for example by adding it to the remit of the investment and governance sub-committee.
- Build it into service provider and adviser contracts - review whether service providers/advisers have the skills and resources to address risks.

#### **Strategy and scenario analysis - steps to take**

- Identify suitable time periods for the scheme and how the scheme might develop.
- Integrate climate risk into regular scheme activities and discussions with the employer.
- Conduct scenario analysis (limited to "so far as the trustees are able"), decide when to carry out further analysis and document the resilience of the scheme.

#### **Risk management**

- Identify climate risks/opportunities and assess impact, and make sure service providers/advisers report on the risks.
- Obtain specific advice on exposure and/or opportunities and discuss this with the employer.
- Include climate risk in scheme documentation, for example in the risk register. Trustees of defined benefit schemes should take account of climate risk when considering scheme funding, the employer covenant and any contingent support and should incorporate considerations into the IRM monitoring framework.

#### **Metrics and targets - steps to take**

- Engage with service providers to select and review metrics, and select an appropriate target for at least one of the metrics and a framework for meeting targets.
- Gather data on greenhouse gas emissions. Trustees must use the data to calculate the metrics, as far as they are able.
- Use the metrics to inform risk management.

### Monetary Penalties Policy

The draft appendix: *breaches of the Climate Change Governance and Reporting Regulations* sets out TPR's policy on levying penalties for non-compliance, as an appendix to its existing *Monetary Penalties Policy*.

The Regulations require TPR to impose a penalty on trustees if they fail to publish their TCFD report on a publicly available website, accessible free of charge and within the timeframe. The minimum penalty is £2,500 and the maximum is £5,000 (if some or all recipients are individuals) or £50,000 (other cases). The draft appendix says that minimum penalties of £5,000 will apply for any consecutive penalty and where the scheme has a professional trustee. In deciding whether to issue a higher penalty, TPR will consider factors such as the nature of the body being fined, the impact of the breach, whether a higher penalty might be more effective in changing behaviour, reasons for failure, and any extenuating circumstances.

In considering whether to impose a discretionary penalty, TPR will adopt the approach set out in the Monetary Penalties Policy in respect of other discretionary penalties. It intends to look at breaches of the Regulations in three band levels, examples of which are:

1. Failing to get the TCFD report signed by the Chair - up to £1,000 for an individual or up to £10,000 for other cases.
2. Failing to disclose scheme resilience in the analysed scenarios - £2,500 (individual) and £25,000 (other cases).
3. Multiple breaches of the requirements to have proper governance of climate risks, with at least one breach in each of the four areas (governance, strategy, risk management, metrics and targets) - £5,000 and £50,000.

**Next steps for trustees:** The draft guidance is a clear warning that TPR will be checking that trustees and their advisers are taking proper account of climate risk and that it will consider taking enforcement action on failure to comply with disclosure duties and obligations under the Regulations. As noted in previous Bulletins, whilst initially applying to large schemes, schemes of all sizes will need to consider their governance of climate risk; the new regime is likely to increase engagement by members with their schemes on climate risk.

## NEW REQUIREMENT TO REFER MEMBERS TO GUIDANCE BEFORE ACCESSING FLEXIBLE BENEFITS

*The Government has started a consultation on regulations requiring trustees to refer members with “flexible benefits” to guidance when they are proposing to access or transfer their benefits. Trustees will be required to ensure that a member has received, or opted out of receiving, Pension Wise guidance before processing their application, and to book the guidance appointment on their behalf.*

The purpose of the consultation, *Stronger Nudge to pensions guidance*, is to seek views on draft amendments to the Disclosure Regulations, which will add new requirements in relation to members looking to access flexible benefits. The consultation runs until 3 September 2021. The consultation does not refer to a start date but the draft Regulations state that they will come into force on 6 April 2022.

**Requirement to refer members to guidance:** Trustees of occupational pension schemes will be required, in certain circumstances, to refer members or survivors (“beneficiaries”) to guidance from Pension Wise via the Money and Pensions Service (MaPS) and to explain the nature and purpose of the guidance. This would apply to members or survivors aged 50 or above with a right or entitlement to flexible benefits under the scheme who apply to access or to transfer their flexible benefits. It would not apply to beneficiaries transferring to a scheme which does not provide flexible benefits or transferring for the sole purpose of consolidation. The referral must be given when an “application” to access or transfer is received by the trustees from a beneficiary. The draft Regulations do not define “application” - the DWP says it is for schemes to make the decision on when the process is triggered. The DWP suggests this should be as early as practical, and ideally, members should be directed to guidance before they have made a final decision about accessing/transferring.

Trustees must not proceed with an application unless the beneficiary has received, and notified them of receipt of, the guidance, or opted out by a separate opt-out notification, and trustees must explain to the beneficiary that they cannot proceed unless this has happened. DWP explains that this means trustees will not be able to send out an

application form or give a quote, although they could send out additional information packs or give generic information on decumulation options. The Regulations will make amendments to the statutory right to transfer, so that trustees will be unable to proceed with a transfer application until the requirements have been fulfilled.

**Booking the appointment:** Trustees must offer to book a Pension Wise appointment on the beneficiary's behalf. Where a beneficiary declines the offer, trustees must provide details of how to book an appointment themselves.

**Opting out:** An opt-out is defined as a notification to the trustees for the purpose of confirming that the beneficiary is opting-out of receiving guidance. It must be separate from the application. Where a member contacts trustees after the referral but before confirming the receipt of guidance or opting-out, the trustees must repeat the steps (offer to book an appointment etc.).

**Exemptions:** There will be exemptions from the requirement to opt out for beneficiaries who confirm that they have already received Pension Wise guidance within the last 12 months, or that they have received regulated financial advice on the proposed transaction. It also exempts those who are applying to access their pension benefits as a serious ill-health lump sum. Trustees should accept self-reported evidence of meeting an exemption, such as the beneficiary providing written or oral confirmation that they believe they meet one of these criteria. There is no proposed exemption for small pots.

**Record keeping:** The proposal is to require trustees to record the receipt of guidance and the provision of opt out notifications, including exemptions.

**Scams guidance:** The DWP notes that it is possible that members will be directed to MaPS for scams guidance and a Pension Wise appointment within the same transaction. It will be up to trustees to consider how they can explain the two guidance appointments to the member.

**Existing disclosure requirements:** Where the new requirement to refer the member to guidance applies, existing requirements to signpost to Pension Wise guidance will not apply. (The existing rules were introduced at the time of the pension flexibilities in 2015 and require signposting on certain occasions, such as if the member requests information about flexible benefits or the trustees and the member communicate about flexible benefits.) Trustees will still have a duty to signpost to Pension Wise guidance in all cases where the new requirement does not apply, such as when a member reaches normal minimum pension age.

Schemes have a duty, under the Disclosure Regulations, to provide a statement explaining the circumstances in which flexible benefits can be transferred out of the scheme. Assuming the draft Regulations are adopted, the DWP points out that schemes may need to update the information they give, to reflect that a transfer for the purpose of accessing flexible benefits cannot proceed until the beneficiary has received or opted out of receiving guidance.

**Next steps for trustees:** As the consultation recognises, it is somewhat confusing that transfers of flexible benefits may result in an overlap of the trustees' duty to refer members for guidance with the requirements for members to receive guidance where there is an "amber flag" for potential pension scams, under the Pension Schemes Act 2021 amendments to the statutory right to transfer. The Government consulted on the amendments earlier this year (see our [Pensions Bulletin May 2021](#)) and the changes are expected to take effect in the Autumn, so trustees should look out for confirmation of the detailed proposals shortly.

## PASA GUIDANCE ON GMP EQUALISATION - CONVERSION GUIDANCE PUBLISHED

*Guidance on Guaranteed Minimum Pension (GMP) conversion has been issued by the GMP Equalisation Working Group convened by the Pensions Administration Standards Association (PASA). This will be useful reading when considering conversion as the method for a GMP equalisation project. The guidance outlines approaches to conversion projects being taken by early adopters together with associated legal, tax and practical considerations, including process flowcharts and worked examples. The guidance notes that tax considerations are resulting in constraints on GMP Equalisation exercises, and that schemes should consider seeking non-statutory clearance where appropriate.*

The guidance looks at three common situations:

- One-off bulk exercise for existing pensions in payment
- At retirement process

- Bulk one-off exercise for deferred members.

It notes that, in practice, the conversion approach taken has tended to be more than a relabelling of the GMP but without dramatic changes to pensions indexation. It is a common objective to design post-conversion benefits to remove many GMP complications, reduce administrative friction and avoid additional complexities of the year by year equalisation method in the ongoing benefits, such as by removing restrictions on commutation and early retirement and anti-franking requirements and simplifying timings of pension increases.

The guidance covers a number of known tricky issues and unanswered questions, particularly in relation to tax (fixed protection and annual allowance issues), and points users towards taking legal advice.

**Next steps for trustees:** Conversion is an option for trustees to consider but the guidance demonstrates the legal and tax challenges that require early scoping advice. As with all PASA guidance, it should be used with caution, and trustees should not assume that any technical conclusions are correct.

## PENSION LEGISLATION AND REGULATION WATCH LIST

No	Topic	Expected effective date	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 have a SIP in place.
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 "towards the end" of 2021 and new Code expected to be operational in December 2022.	Once in force, the Code will apply to triennial valuations submitted thereafter.
4	Pension Schemes Act 2021: TPR powers; scheme funding; CMP schemes; pension dashboards	Different implementation dates expected for different parts	Regulations and further consultation expected.  Climate risk provisions - see 8 below. Restrictions on transfers - see 10 below.
5	TPR consolidated Code of Practice	"Late 2021"	TPR consultation issued 17 March 2021 and closed 26 May 2021.
6	Trustee oversight of fiduciary managers and investment	Under the Investment Consultancy and Fiduciary Management Market Investigation Order 2019,	Consultation response and new DWP regulations have been delayed until June 2022.

No	Topic	Expected effective date	Further information/action
	consultants	compliance statements, confirming the extent to which requirements have been met, had to be provided to CMA by 7 January 2021.	
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 2021	1 October 2021	<p>Applies to schemes (DB and DC) with £5 billion or more in net assets on the first scheme year end date on or after 1 March 2020, as well as to all authorised master trusts and all collective DC schemes. 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.</p> <p>Revised draft Regulations and statutory guidance issued with response to second consultation.</p> <p>TPR draft guidance issued for consultation July 2021.</p>
9	Changes to DC scheme governance and disclosure, including changes to the annual Chair's statement and to the charge cap	<p>October 2021; detailed value for money assessments for schemes with assets below £100m required for first scheme year ending after 31 December 2021</p> <p>April 2022: introduction of £100 de minimis pot size below which flat fees cannot be charged</p>	<p>DC schemes only.</p> <p>Response to consultations, together with final statutory guidance and final regulations, published June 2021.</p> <p>DWP to confirm whether look-through mechanism for charge cap compliance will be amended or removed.</p> <p>DWP to review whether fines</p>

No	Topic	Expected effective date	Further information/action
			for non-compliance with Chair's statement requirements should be mandatory.
10	Restrictions on transfers of a member's cash equivalent transfer value by trustees/managers of occupational or personal pension schemes unless prescribed conditions are met	Autumn 2021	Consultation on draft regulations closed 10 June 2021.
11	DB superfunds	Regulatory regime expected Autumn/Winter 2021	Interim regulatory regime in place from October 2020.
12	Trustees must refer DC members to guidance before processing application to access or transfer flexible benefits	April 2022	Consultation on draft regulations issued July 2021.

**London**

T +44 (0)20 7600 1200  
F +44 (0)20 7090 5000

**Brussels**

T +32 (0)2 737 94 00  
F +32 (0)2 737 94 01

**Hong Kong**

T +852 2521 0551  
F +852 2845 2125

**Beijing**

T +86 10 5965 0600  
F +86 10 5965 0650

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