SLAUGHTER AND MAY/

BULLETIN

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PENSIONS BULLETIN

QUICK LINKS

Welcome to the September 2020 Pensions Bulletin from Slaughter and May. In this month's edition, we focus on the Government's proposals for climate risk reporting by large pension schemes and recent announcement on the increase in the normal minimum pension age. We look at a wide-ranging consultation on DC scheme governance, as well as the latest from the Pensions Regulator on reporting obligations. There is an update on legislation affecting pension schemes and, finally, a report on a case about investment loss resulting from a delayed transfer.

CONSULTATION ON CLIMATE RISK GOVERNANCE AND REPORTING

Trustees need to prepare for legislation and statutory guidance on reporting of climate risk issues. Obligations will cover governance, strategy and scenario analysis, risk management, metrics and targets. There will be annual reporting requirements on compliance. Whilst initially applying to large schemes, schemes of all sizes will need to consider their governance requirements in the light of the proposals. (A more detailed analysis of the consultation can be found in our publication: Improving governance and reporting of climate-related issues in occupational pension schemes.)

DWP published a consultation on 26 August 2020: *Taking action on climate risk: improving governance and reporting by occupational pension schemes*. Consultation closes on 7 October 2020. The DWP proposes that trustees of schemes in scope (see below) will be required to address climate risks and opportunities through effective governance and to publish an annual report on these measures. This is in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The proposed reporting timescales are tight and there would be penalties for failure to report. Details will be contained in regulations under the Pension Schemes Bill and in statutory guidance.

The proposals are in addition to recently introduced requirements on trustees to state in the scheme's Statement of Investment Principles (SIP) their policy in relation to financially material considerations, including ESG factors, and to report on how and the extent to which they have followed them (through Implementation Statements).

Scope and timing: Schemes (both DB and DC) with £5 billion or more in net assets on the first scheme year to end on or after 1 June 2020, as well as all authorised master trusts and all collective DC schemes, would be required to:

- have climate risk governance for the scheme year underway from 1 October 2021; and
- publish an annual report (the TCFD report) – the first within seven months of the end of the scheme year, or by 31 December 2022 if earlier.

The requirements would be extended to schemes with assets of £1 billion or more one year later. Where net scheme assets exceed £1 billion on the first scheme year to end

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on/after 1 June 2021, the governance requirements would apply for the scheme year underway from 1 October 2022 and the TCFD report would be due seven months after the end of that scheme year, or 31 December 2023 if earlier.

Schemes would remain in scope until assets fell below £500 million at scheme year-end. The DWP will consider in 2024 whether to extend the requirements to smaller schemes.

Requirements: Schemes would be required to:

- Establish and maintain governance in line with the TCFD recommendations.
- Carry out a variety of activities including strategy and scenario analysis, risk management, metrics and targets.
- Publish the TCFD report so it is accessible for free on a publicly available website.
- Tell members via their annual benefit statements where they can locate the TCFD report. (For DB schemes, this would apply only for members for whom trustees are already required to produce an annual statement.)
- Provide TPR with the web address of where they have published their TCFD report, via the annual scheme return, and reference the TCFD report from the scheme's annual report and accounts.

The consultation makes clear the Government's view that climate risks (and ESG risks more broadly) are likely to be financially material and therefore that trustees have a duty to take account of these risks when setting investment strategy. Nevertheless, the Government acknowledges that it cannot dictate trustees' investment decisions. Whilst some of the regulations and guidance will be quite prescriptive, the Government recognises that there are unlikely to be sufficient data to allow a full analysis to be carried out. Accordingly, trustees will be able to "comply or explain" (i.e. explain why guidance is not being followed) or in some cases trustees must meet the requirements "as far as they are able" to do so.

The DWP proposes a mandatory penalty (minimum £2,500) only for wholesale non-compliance - i.e. failure to publish a TCFD report at all. Penalties for reports that TPR deems to be inadequate in meeting the requirements would be subject to discretion (maximum £5,000 for individual trustee; £50,000 for corporate trustee). Additionally, requirements to reference the TCFD report in the annual report and to inform members would be subject to the existing penalty regime in the Disclosure Regulations.

In a section on reporting to TPR, the consultation includes a proposal to amend the regulations on annual scheme returns to require trustees to include the website address where their SIP, Implementation Statement and (for DC schemes) excerpts of the Chair's Statement are located. It is not clear whether this is intended to apply to all schemes regardless of size.

INCREASE OF NORMAL MINIMUM PENSION AGE TO 57 IN 2028

At present, the earliest age at which pension benefits can be taken in authorised form for tax purposes is age 55 except where a member benefits from a protected Normal Minimum Pension Age (NMPA). The Government has confirmed that NMPA is going to change in 2028 to age 57. However, it remains unclear whether any current rights to take benefits at age 55 will be grandfathered, and whether the NMPA will rise again when state pension age increases beyond 67.

The Government confirmed, in answering a written parliamentary question, that it will legislate "in due course" for a rise in NMPA to 57 in 2028.

This was originally raised in 2014, as part of the consultation in relation to the introduction of pension freedoms. In its response, in July 2014, the Government confirmed that the NMPA would rise to 57 in 2028 for all schemes except public service schemes for Firefighters, Police and the Armed Forces. The response went on to say that the NMPA would remain at 10 years below State Pension Age (SPA) thereafter (under the Pensions Act 2007, SPA is due to rise from 67 to 68 between 2044 and 2046). Industry representations were made that careful thought would need to be given as to whether current rights to take benefits at an earlier age would be grandfathered and in what circumstances. In its 2014 response to consultation the Government said it was "*considering the nature and extent of any protection that might be required for those individuals. The government will be guided by simplicity and fairness, both for* *individuals and for schemes, in designing any protection that may be introduced*" and recognised there were further issues to explore in designing the increase.

GOVERNMENT CONSULTATION ON DC SCHEME GOVERNANCE

The Government announced consultation on further measures to improve DC scheme governance and disclosure to scheme members, and to promote diversification of investment. The Government is encouraging smaller DC schemes to consolidate. Trustees need to be ready for changes to the content of the annual Chair's Statement and new reporting obligations.

The Government has responded to its February 2019 consultation on "*Investment Innovation and Future Consolidation*" with further consultation on draft regulations and statutory guidance, designed to improve DC scheme governance and disclosure to scheme members, and to promote diversification of investment portfolios. The consultation closes on 30 October 2020 and the changes would take effect from October 2021.

Reporting: All DC schemes (not just those required to produce a Chair's Statement) would have to report to the Pensions Regulator (TPR), in their annual scheme return, the total value of assets held in the scheme for the purpose of providing benefits.

Chair's Statement: In relation to the value for members (VFM) section of the annual Chair's Statement, the Government notes that costs and charges are best understood in the broader context of what the scheme delivers. Therefore, the proposal is for trustees to consider the level of net investment returns as part of the VFM assessment. All DC schemes, regardless of size, would be required to publish net returns for their default and self-selected funds (from 2015 onwards) in the annual Chair's Statement. Draft statutory guidance sets out how returns would be shown. The disclosure requirements for costs and return on investments would be extended to self-select funds which are no longer available for members to choose (i.e. those that are closed to future contributions). There will be amendments to the statutory guidance on how costs and charges information should be set out in the Chair's Statement. As part of the drive to consolidation (see below), smaller schemes will be required to complete a new VFM assessment.

Consolidation of under-performing schemes: The Government notes that, of approximately 3000 DC schemes on the TPR register, over two-thirds have 100 members or fewer, and 1300 have fewer than 12 members. In last year's consultation, the Government suggested extending the VFM assessment to include consideration of whether it might be in members' interests to be transferred into another scheme, such as an authorised master trust. The new requirement was to be applied to schemes with less/fewer than £10m in assets or 1,000 members. The Government has now decided that the VFM assessment should apply instead to schemes with assets below £100 million that have been operating for at least three years. The annual assessment would follow statutory guidance and cover:

- costs/charges and net investment returns (measured against at least three comparator schemes); and
- administration and governance criteria: promptness and accuracy of financial transactions; appropriateness of default investment strategy; quality of investment governance, record keeping and member communication; level of trustee knowledge, understanding and skills; and management of conflicts of interest.

Trustees would be required to report to TPR, via the annual scheme return, the outcome of the assessment and their intended action if the scheme does not represent good VFM. Where the trustees do not demonstrate VFM under the new assessment, they would have to take immediate steps to wind up the scheme and consolidate members into a larger scheme, unless in exceptional circumstances they could make the necessary improvements rapidly and in a cost effective way.

Illiquid assets: With the aim of encouraging investment in illiquid assets, the Government proposes adjustments to the compliance mechanism for the charge cap in auto-enrolment default funds, to allow trustees greater flexibility to pay performance fees. Changes to the regulations would also confirm that the costs of holding physical assets, such as real estate or infrastructure, are not included within the charge cap. Meanwhile, the Government's general review of the charge cap is due to be published later this year.

The Government is not now planning to continue with an earlier proposal for larger schemes to state their policy on illiquid investments in their Statement of Investment Principles (SIP) and to report the holdings in illiquid investments in the Implementation Statement. It will continue to monitor this and to review diversification in investment, focusing on the largest schemes.

Other proposed investment governance changes include:

- Extending the requirement to produce a default SIP to "with profits" default arrangements.
- Excluding wholly insured schemes from the SIP requirements on trustees' policies on arrangements with asset managers. This is to correct an oversight when new requirements (effective from October 2020) were introduced last year. On timing, the Government notes that TPR will not prioritising enforcement action before this proposed change is in force in October 2021.

END OF COVID EASEMENT - RESUMPTION OF REPORTING TO TPR

From the start of next year, the duty to report late payment of DC contributions will revert to applying to payments that are 90 days late. From 1 October 2020, the Pensions Regulator (TPR) will resume its review of Chair's Statements.

In June, TPR updated its COVID-19 hub to reflect the ending, on 30 June 2020, of the easements on reporting breaches. From 1 July, pension scheme trustees were required to resume reporting information to TPR (see our Pensions Bulletin - June 2020). One of the exceptions to the ending of easements was for late payment of DC contributions, where DC and auto-enrolment providers were given 150 days (instead of 90 days) to report late payments. TPR said at the time that this extension would be reviewed at the end of September 2020, when the results of the 150-day reporting period would be seen.

TPR has decided that the timescale for reporting will revert to 90 days, as set out in its Codes of Practice. Contributions that are outstanding for over 90 days must be reported from 1 April 2021, and schemes are asked to do so from 1 January 2021.

TPR's announcement confirms that, from 1 October 2020, it will resume other enforcement activity:

- review of Chair's Statements;
- enforcement of preparation of audited accounts; and
- regulatory action if a review of a Statement of Investment Principles (or statement in relation to any default arrangement) is delayed.

Chair's Statements should not be submitted until 1 October 2020, as TPR says that any Statements received before 30 September 2020 will be returned unread. There is a further reminder that the legislation does not give TPR any discretion about imposing fines where it is notified, or forms the view, that the trustees have not prepared a compliant Statement on time.

LEGISLATIVE UPDATE

The Corporate Insolvency and Governance Act, which has significant implications for pension schemes, is now in force. The Pension Schemes Bill is about to resume its progress through Parliament, while trustees must prepare for the end of the Brexit implementation period.

Corporate Insolvency and Governance Act 2020

The Corporate Insolvency and Governance Act 2020 introduces measures to provide greater flexibility for companies to explore different rescue options and temporarily to protect companies from creditor action, including a new statutory moratorium and restructuring plan procedure.

Neither moratoriums nor restructuring plans under the Act are qualifying insolvency events and so the provisions of the Pensions Act 2004, which would normally trigger the start of an assessment period and the involvement of the Pension Protection Fund (PPF), do not apply.

As a consequence of concerns raised by the pensions industry, the Government amended the Bill before it was enacted. The amendments ensure that the Pensions Regulator and the PPF will be given information similar to other creditors on a moratorium and restructuring plan. In addition, the PPF will have creditor rights under both processes. It will also not be possible for banks to accelerate payment of their debts during a moratorium, in such a way that the total amount of unsecured debt has super priority ranking ahead of the pension scheme debt.

Pension Schemes Bill

The Pension Schemes Bill has finished its passage through the House of Lords and is set to resume its Commons stages. The Bill contains a statutory basis for collective defined contribution schemes, sets out an array of new Pensions Regulator powers, and introduces the new Pensions Dashboard. There are also new measures on climate risk reporting (discussed above), scheme funding and transfers.

Brexit

The 30 June 2020 deadline for extending the implementation period has now passed and there is little sign of substantive progress in the negotiations on the future of the UK-EU relationship. Trustees must consider the possibility of a no-deal or "minimal deal" scenario following the end of the implementation period at 11:00pm on 31 December 2020. Trustees need to check with scheme administrators and consider the Pension Regulator's guidance notes for DB and DC schemes on investments, member communications, and operations and administration. For more details, see our publication Brexit: pension scheme preparedness.

INVESTMENT LOSS RESULTING FROM TRANSFER DELAY

A word of warning about the risk of delayed transfers. In this case, the court was willing to compensate the member for the lost opportunity to invest in the stock market.

In *Mr T* (12 August 2020), the Pensions Ombudsman (TPO) assessed loss following a complaint brought by T about a scheme administrator's delay in transferring his pension to a new provider. The High Court, in *Tenconi v The James Hay Partnership [2019] EWHC 2286 (Ch)*, had found that a scheme administrator was liable for investment loss resulting from a five-month delay in effecting a transfer to a Self-Invested Personal Pension (SIPP). As a result of the delay, T lost the opportunity to take advantage of the sharp fall in the FTSE 100 Index following the Brexit referendum, and its subsequent recovery. T had instructed the administrator to transfer his funds to a new SIPP in March 2016; significantly, he had specified that this be done ahead of the referendum. The High Court found that T's subsequent investment loss was foreseeable and measurable and sent the case back to TPO to identify the date the money should have been made available to T and for T to show what he would have done on that date, on the balance of probabilities.

In the review, TPO held that, had there been no maladministration, T's transfer request would have been completed by 23 June 2016 and that, on the balance of probabilities, T would have invested the full £250,000 in the FTSE 100 Index immediately after the leave vote (when the Index fell). In doing so, he would have gained a financial profit of £43,700 in August 2016 following the Index's subsequent recovery. In the light of this finding, TPO directed the trustee to pay £47,300 plus interest into T's SIPP.

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