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BULLETIN

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PENSIONS BULLETIN

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In this month's Pensions Bulletin, we cover:

1. HMRC issues helpful guidance on how GMP equalisation transfer top-ups fit with the tax regime, as well as an update on conversion. Meanwhile, the Bill on conversion is making good progress through Parliament.
2. Conflict in Ukraine: what the Pensions Regulator expects trustees to be considering.
3. Best practice for trustees from 1 June for new DC communication ("Stronger Nudge") requirements.
4. Pressure on DC trustees to consider investment in illiquid assets.
5. Guidance for pension scheme investors on their stewardship duties.
6. New notification requirements for DB schemes are delayed.
7. List of legislation and regulation expected from 2022 to 2023.

GMP EQUALISATION: TRANSFERS AND CONVERSION: HMRC NEWSLETTER ISSUED AND CONVERSION BILL PROGRESSING

HMRC have issued their third newsletter on GMP equalisation, giving helpful guidance on how transfer top-ups fit with the tax regime, and an update and some limited guidance on conversion. A number of other issues have been identified with the conversion method; some of these are being addressed in the Private Members' Bill that is going through Parliament with Government support.

For transfers, HMRC's view is that the methods for settling a right to a top-up payment fit within the authorised payment requirements, and that a variety of commutation lump sum types can be used to make payments direct to members. The newsletter considers a number of detailed points including the income tax treatment of lump sum payments and the effect on tax protections.

For conversion, HMRC acknowledge that conversion is likely to impact on annual allowance and fixed protection status for members who have not yet retired. They are undertaking further work on annual allowance including looking at the potential for legislative change. However, for fixed protection, there is no mention of potential legislative change. The newsletter also includes helpful guidance on some technical tax points relating to pensioners and pre 6 April 2006 deferred members.

For full analysis of the HMRC newsletter and further information on the conversion Bill, please see our briefing: *GMP equalisation: transfers, conversion and tax: an update*.

GUIDANCE FROM THE PENSIONS REGULATOR ON THE CONFLICT IN UKRAINE

The Pensions Regulator (TPR) has published Guidance: Conflict in Ukraine. Trustees are expected to consider the potential risks arising with advisers, particularly in relation to investments.

TPR's *Guidance: Conflict in Ukraine* says that scheme trustees should be vigilant and talk to advisers about action which may be needed, depending on investment, risk management or employer covenant exposures. Trustees should consider any necessary steps to align with UK Government sanctions. Particular areas TPR expects trustees to consider include:

- For DB schemes, short-term liquidity needs and how they might be affected by margin calls (demands to make further deposits to cover possible losses) and the meeting of short-term member benefit payments.
- The impact on the scheme employer's operations, either directly or through wider trading links or broader factors such as inflation, increased fuel prices or foreign exchange risks.
- The likely impact on scheme investments.
- Whether investments remained aligned with the principles set out in the Statement of Investment Principles, including ESG considerations. This raises the potentially difficult issue as to whether pension schemes can divest from assets classes on the basis of non-financial factors.
- Whether cyber safety procedures need further consideration.
- Whether procedures should be reviewed in the light of the increased risk of financial crime and scams.

Trustees should consider whether to communicate with members, to inform them of the steps being taken to manage risks.

The Pensions Protection Fund (PPF) has also commented on Ukraine. In a Press Release on 7 March 2022, PPF stated that its investment exposure to Russia is negligible and, as a result, it does not expect any material financial impact, whilst recognising that the recent volatility in the financial markets could have wider impacts.

Next steps for trustees: Trustees should consider the TPR guidance with their advisers and service providers. Trustees who have entered into derivatives, typically to hedge against interest rate and inflation risk, may want to discuss the problems raised in a Briefing prepared by our derivatives team. The briefing highlights the issues market participants in derivatives are, or should be, thinking about in trying to assess and manage their derivative exposures in light of the crisis. Parties are identifying transactions which are, or could become, impacted by sanctions, export and capital

controls being implemented around the world and by related market disruption, including the impact on energy and commodity prices and potentially heightened counterparty risk.

COMMUNICATING WITH MEMBERS ABOUT GUIDANCE BEFORE ACCESSING FLEXIBLE BENEFITS

TPR has updated its DC communications guidance to include the requirement, from 1 June 2022, to refer members to guidance before processing an application to access flexible benefits.

Earlier this year, the Government finalised regulations on a new “Stronger Nudge” requirement (from 1 June 2022) for trustees to ensure that a member aged 50 plus has received, or opted out of receiving, guidance before processing their application to access (or transfer in order to access) flexible benefits. Please see our *Pensions Bulletin January 2022* for details of the new requirements. Following on from this, the Pensions Regulator (TPR) has updated its guidance on *Communication and Reporting: DC Schemes*. TPR has added content, in the “At retirement communications” section, on directing members to Pension Wise guidance, including a best practice example of the process. Trustees should note that:

- The new requirements do not apply to applications already in process before 1 June 2022.
- Trustees must offer to book a Pension Wise appointment for the member. TPR regards it as good practice to make this offer as early as possible in the process.
- Trustees must ensure their processes are updated to include the requirement to offer to book a Pension Wise appointment. For postal and on-line applications, TPR would expect to see a covering letter or web page confirming:
    - an offer to book a Pension Wise appointment, along with contact details;
    - the telephone number for Pension Wise and web address, so that the member can contact them directly if they prefer; and
    - instructions on how to opt out by completing a separate form or communication, if the member does not wish to take up the offer of guidance.
- Where a member wishes to opt out, trustees may wish to consider encouraging the member to take some time to consider before confirming their decision.
- Where the member declines Pension Wise guidance, and the exemptions from the need for a separate opt out (the member has received regulated guidance in the past 12 months or is transferring benefits or applying for a serious ill-health lump sum) do not apply, TPR expects the separate communication to be a further telephone call, an online opt out form through a member portal, or an email or separate form provided with an application.
- Once a member has confirmed that they have received or opted out of Pension Wise guidance and makes contact to access their flexible benefits, the trustees must also provide the usual generic or personalised risk warnings. TPR has updated its example of a retirement options declaration wording to include references to the Pension Wise guidance.

There is no discussion of how to deal with the scenario where a member is referred for guidance under both the Stronger Nudge and one or more of the other regimes - the new statutory transfer regime, where there is an “amber flag”, the need for “appropriate independent advice” where a member is transferring DB rights of £30,000 or more, and the pre-retirement “wake-up” packs.

Next steps for trustees: Trustees should consider whether their communications need updating to refer to the Stronger Nudge requirements. Trustees may want to consider what further steps it wishes to take where a member wishes to opt out, in the light of TPR’s suggestion as to whether to encourage the member to take more time. Trustees using third party administrators should check that updated paperwork and processes will be ready for 1 June. If the administration is in-house, the new requirements must be integrated into the transfer/retirement procedures. Robust documentation of the process is required – if there is no confirmation or opt-out from the member, there is no statutory transfer right and

consequently no statutory discharge for the trustees. Failure to comply with the requirements would also be a breach of the Disclosure Regulations, with potential civil penalties.

GOVERNMENT PROPOSALS TO ENCOURAGE DC TRUSTEES TO INVEST IN ILLIQUID ASSETS

The Department for Work and Pensions (DWP) has started a consultation on further proposals to encourage DC investment in illiquid assets. It will consult again on removing performance-based fees from the charge cap and has revived a previous proposal to require DC schemes to disclose and explain their policies on illiquid investment and (for medium and larger schemes) to explain their default asset class allocation in the Chair's Statement. No date has been set for implementation of the disclosure proposals. The Government has also confirmed that it will not be introducing any new DC consolidation requirements in 2022.

On 30 March 2022, the DWP published a consultation, closing on 11 May 2022, on *Facilitating investment in illiquid assets*. The eye-catching proposal relates to DC trustees' **policies on investment in illiquid assets**. The Government is suggesting:

1. An amendment to the requirements on the content of Statement of Investment Principles (SIP), to oblige trustees to include an explanation of their policy on illiquid investment. This would apply to default arrangements of occupational DC schemes only. (For hybrid schemes, it would apply to the DC section only.)
2. Requiring DC schemes with over £100m in total assets to disclose and explain their default asset class allocation in their annual Chair's Statement.

The rationale behind the first proposal appears to be two-fold: to stimulate competition in the DC market and to promote transparency - if trustees do not allocate to illiquid assets, members should understand why the scheme invests only in equities and bonds. The DWP comments that the Government is not requiring trustees or investment managers to change their asset allocation but rather "*to reflect on the decisions they have already made, and the decisions they will make, as part of their ongoing fiduciary duty to create an investment approach that works optimally for members*".

The timeframe for disclosure would be consistent with that for SIPs i.e. at least every three years and without delay after any significant change in investment policy.

The policy statement, which the DWP envisages would be between one and three paragraphs, would refer to the following:

- what illiquid assets are and whether trustees choose to invest in them;
- which members will be holding illiquid assets (does the scheme lifestyle members in and out of illiquid assets and, if so, at roughly what age?);
- a description of allocations, including whether the investment is direct or indirect and under which asset classes the investments fall;
- why trustees decided to make an allocation to illiquid assets (including their assessment of the benefits to members) or, if they decided not to make an allocation to illiquid assets, the reason for that decision;
- what factors trustees consider when deciding whether to invest in illiquid assets; and
- any current barriers to, or future plans for, investment in illiquid assets.

Under the second proposal, DC schemes with over £100m assets under management would have to disclose in their annual Chair's Statement (if required to produce one) the percentage of assets allocated in the default to each of the seven main asset classes: cash; bonds; listed equities; private equity (including venture capital and growth equity); property; infrastructure; and private debt. The DWP would issue guidance for trustees on how to disclose this information; the consultation paper includes a worked example of a disclosure.

The DWP also reports its latest thinking on its proposal to **exempt performance-based fees from the regulatory charge cap.** The Government takes the view that the charge cap for default arrangements of occupational DC schemes used for auto-enrolment (0.75% of funds under management within the default arrangement) limits DC schemes' ability to invest

in illiquid assets that come with performance fees. In December 2021, the DWP asked for views on proposals to exclude performance fees from the charge cap (see our *Pensions Bulletin December 2021*). The DWP reports mixed responses to the consultation and has decided it will continue to consult on the proposed change and on principle-based guidance.

The DWP notes that the current regulations relating to **employer-related investments** (ERI) present a barrier to DC authorised master trusts expanding their investment strategies to include private debt/credit. Currently, as with other multi-employer schemes, master trusts are required to ensure that none of the participating employers (or their associates or connected persons) have any involvement in direct loans from the scheme and that they do not hold more than 5% of their investments in any single employer (or 20% in all employers). From 1 October 2022, for authorised master trusts with 500 or more active employers, the definition of ERI will be amended so that restrictions will apply only to investment in the scheme funder, the scheme strategist, or a person who is connected with or an associate of the scheme funder or the scheme strategist.

The final part of the consultation is an update on the Government's aim of encouraging **consolidation of DC schemes**. Last year, the Government introduced requirements for DC schemes with assets of less than £100m to publish a detailed "value for members" (VFM) assessment, effective from the first scheme year ending after 31 December 2021 (please see our *Pensions Bulletin June 2021*). At the same time, the DWP published a Call for Evidence on the barriers to further consolidation of the occupational DC market for schemes with between £100m and £5bn of assets. In response to that consultation, the DWP reports that it is encouraged by data published by the Pensions Regulator (TPR), which suggests that consolidation is continuing to take place "at a healthy pace". Therefore, the Government "*will not be introducing any new regulatory requirements with the sole purpose of consolidating the market in 2022*". However, it will work closely with TPR to monitor the impact of the VFM assessments.

Next steps for trustees: It is clear that the Government is determined to increase DC trustees' investment in illiquid assets. Trustees may want to consider with their advisers the extent of their current holding in illiquid assets. Despite the assurances in the consultation paper, there will be concerns that this could be another area where Government regulation may cut across the trustees' fiduciary duty to invest in the best financial interests of their members.

PLSA STEWARDSHIP AND VOTING GUIDELINES

The Pensions and Lifetime Savings Association (PLSA) has issued an updated version of its Stewardship and Voting Guidelines, its guidance to support pension scheme investors to understand "how to do" stewardship and engagement and the role exercising a vote plays within that framework. The PLSA recommends that all pension scheme decision-makers should discussing the guidelines with advisers and managers.

The PLSA's *2022 Stewardship and Voting Guidelines* is aimed at pension scheme investors, their investment service providers and companies that use the guidelines as a benchmark for their corporate reporting and investor relations work. The guidelines are not mandatory but the PLSA recommends that all pension scheme decision-makers should discuss them with advisers and managers.

The PLSA guidance sets out the corporate governance and stewardship regimes in the UK, and covers:

- What the regulations on shareholder engagement mean for scheme investors and how corporate governance and stewardship relate to each other. It explains stewardship and engagement, providing checklists and glossary terms.
- What investors should look for when it comes to assessing corporate behaviour and governance overall and where they might find key evidence and metrics to help them make a decision.

One of the key areas highlighted is climate change – the PLSA notes that, as the pensions sector is now within the scope of requirements to produce an annual Taskforce for Climate Related Financial Disclosure (**TCFD**) report, the PLSA expects the TCFD framework to be referenced in investee company reports. If a large company does not reference the TCFD framework, the 2022 Guidelines recommend that investors consider voting against the company's climate change and sustainability policy.

The PLSA endorses the recommendations of the Government-sponsored Taskforce on Pension Scheme Voting Implementation, including:

- Trustees should either set their own voting policy or acknowledge responsibility for the voting policies asset managers implement on their behalf.
- Trustees should assess the efficiency of implementation of voting policies.
- Where possible, trustees should set an "expression of wish" on voting across on all pension investment structures.

These recommendations on voting also appear in the DWP's proposed guidance on stewardship reporting in Statements of Investment Principles (SIPs) and Implementation Statements. The guidance, issued for consultation in October last year, is intended to develop best practice for reporting in SIPs and Implementation Statements. The sections on SIPs are "best practice" but the guidance in relation to Implementation Statements would be statutory guidance, to which trustees must have regard when complying with the requirements in the Disclosure Regulations. For more detail on the proposed guidance, please see our *Pensions Bulletin October 2021*.

Next steps for trustees: The PLSA guidance is a helpful starting point for trustees to discuss stewardship with advisers. Trustees should look out for the finalised guidance on SIPs and Implementation Statements.

DELAY IN NEW NOTIFICATION REQUIREMENTS FOR DB SCHEMES

There has been an unexplained delay in the implementation of the Government's proposals to introduce new notifiable events for sponsors of DB pension schemes. We had expected the new requirements to come into force from April 2022.

Last September, the Government started consultation on new notification requirements for corporates with DB pension schemes planning disposals, acquisitions or the introduction of new secured debt. Notification to the Pensions Regulator will be required at an early stage of a transaction and more detailed disclosures - which will necessitate disclosure to and interaction with trustees - on the impact of the transaction on the pension scheme will also be required before the transaction completes. The Government consultation and draft regulations raised a number of details questions on timing. (For details, please see our *Pensions Bulletin September 2021*.) There was no confirmation in the consultation as to when the new requirements would take effect but the draft regulations had a commencement date of 6 April 2022. The consultation closed in October last year but the Government has not issued a response to the consultation or the final version of the regulations. The reason for the delay is unclear but it is possible that the new regime will not now take effect until October 2022, as pension legislation is generally issued only twice a year, in April and October.

PENSION LEGISLATION AND REGULATION WATCH LIST

No	Topic	Expected effective date	Further information/action
1	Changes to DC scheme governance and disclosure, including the annual Chair's statement and charge cap	First scheme year ending after 1 October 2021 - return on investments from default and self-select funds included in Chair's Statement; 5 October 2021- total value of assets reported in annual scheme return; first scheme year ending after 31 December 2021 - detailed "value for members" assessments for schemes with assets below £100m.	DC schemes only. DWP to confirm whether look-through mechanism for charge cap compliance will be amended or removed. DWP to review whether fines for non-compliance with Chair's statement requirements should be mandatory. DWP proposals on universal charging structure to follow. Consultation on requirements

No	Topic	Expected effective date	Further information/action
		Fee charging years ending after April 2022: £100 de minimis pot size below which flat fees cannot be charged	to include explanation of illiquid investment policies in SIPs and (for large schemes) asset allocation data in Chair's Statement; further consultation on removal of performance-based fees from charges cap.
2	Restrictions on transfers of member's cash equivalent transfer value by trustees/managers of occupational or personal pension schemes unless prescribed conditions are met	Transfers where the date of the member's application for a statement of entitlement (DB schemes) or transfer request (DC schemes) occurs on or after 30 November 2021	
3	Trustee oversight of fiduciary managers and investment consultants		Consultation response and new DWP regulations have been delayed until June 2022.
4	DB superfunds	Regulatory regime was expected Winter 2021	Interim regulatory regime in place from October 2020.
5	New notification requirements for DB schemes in relation to corporate and financing activity and change to the notification process	Draft Notifiable Events (Amendment) Regulations, published for consultation September 2021. Expected commencement date less certain	Consultation closed 27 October 2021. TPR Code of Practice 2 (Notifiable Events) will be updated.
6	Refer members to guidance before processing application to access or transfer flexible benefits	1 June 2022	For DC schemes only.
7	Draft DB Funding Code of Practice	DWP regulations expected for consultation "Spring 2022". Part 2 of TPR consultation and draft Code expected "late Summer 2022". New Code expected to be operational in December 2022	Once in force, the Code will apply to triennial valuations submitted thereafter.

No	Topic	Expected effective date	Further information/action
8	TPR consolidated Code of Practice	Revised Code to be issued before Summer Recess (expected to be 21 July 2022), to come into force early Autumn 2022	TPR consultation issued 17 March 2021 and interim response issued August 2021.
9	Register certain trusts with the Trust Registration Service	Registration by 1 September 2022	Applies to some trusts relating to pension and life assurance benefits where no exemption applies (e.g. bare trusts set up on distribution of a lump sum).
10	Climate risk governance and reporting requirements	1 October 2022	1 October 2022 for schemes with £1 billion or more in net assets, governance to be in place for the scheme year underway, and the first annual report to be published within seven months of the end of the scheme year. (1 October 2021 deadline applied for all authorised master trusts and collective DC schemes and schemes with £5 billion or more in net assets.)
11	Simpler annual benefit statements	1 October 2022	DC schemes used for auto-enrolment.
12	Changes to the scheme asset information collected through scheme returns	Scheme returns from 2023	DB schemes.
13	Pensions dashboards	Staging deadlines from 30 June 2023	All registerable UK-based schemes with active and/or deferred members.

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