LCP INSIGHT CLARITY ADVICE

Our guide to the Pension Schemes Act 2021

January 2021

The Pension Schemes Act puts onto the statute book a tougher regulatory regime for DB pension provision from the corporate perspective. But quite how the Government will implement it as corporate Britain struggles with the economic consequences of the lengthy Covid-19 pandemic and any Brexit-related downturn remains to be seen.

This guide sets out and comments on the Act's key provisions, with the aim of assisting trustees, employers and scheme managers to understand the legislation made so far and the actions that they may need to take.

Contribution notices, criminal offences and new civil penalties

For DB schemes, there are some significant additions to and adjustments of the current powers that the Pensions Regulator has in relation to issuing contribution notices to corporate targets demanding that they make substantial payments to schemes.

Two new criminal offences are also created with no limitation on who could be in scope.

Two new contribution notice triggers

Contribution notices will now be possible if either an "employer insolvency test" or an "employer resources test" is failed.

- The first new test is where an act or failure to act "would have materially reduced the amount of the [section 75] debt likely to be recovered by the scheme".
- The second new test is where an act or failure to act "reduced the value of the resources of the employer" and "that reduction was a material reduction relative to the amount of the estimated section 75 debt in relation to the scheme".

(The section 75 debt is the amount due to a scheme in certain situations including employer insolvency. For a single employer scheme this broadly represents the deficit against a buyout measure. For a multi-employer scheme, it is their share of that deficit.)

There is a statutory defence – "the ABC defence" – available to targets of the new contribution notices. If they can demonstrate that they gave due consideration in advance to the impact of the act or failure to act and either concluded that there was no material reduction in the recoverable debt/employer resources or else provided appropriate mitigation against any reduction then that will be a legal defence. The existing clearance mechanism will also continue to be available.

Our viewpoint

Two new contribution notice triggers

The two new contribution notice triggers are designed to be easier for the Regulator to use than the current two triggers. There is significant uncertainty as to what scenarios are potentially in scope, with Parliamentary exchanges shedding little light. But it seems likely to us that a number of corporate activities that have previously been deemed normal business practice will in the future need to be considered in much more detail from a pensions perspective in order to avoid a contribution notice risk.

Sum specified in the contribution notice and its due date

The "relevant time" as at which the Regulator estimates the section 75 debt, which informs the amount that would be due under a contribution notice, is defined. Currently, it is thought to be when the trigger event occurred. Relevant time will now be simply the end of the scheme year which ended most recently before the day on which the Regulator gives a determination notice in respect of an intended contribution notice. This will mean that the amount demanded by the Regulator can be much closer to the scheme's section 75 debt at the time the Regulator issues its determination, rather than when the trigger event occurred. This could have a dramatic effect on the amount set out in a contribution notice.

Separately, failing to pay any contribution notice by its due date will constitute either a criminal offence leading to a fine or attract a new scale of civil financial penalties of up to £1m.

Two new criminal offences

A new criminal offence of the "avoidance of employer debt" occurs if a person prevents the recovery of all or part of a section 75 debt, prevents it from becoming due, compromises or otherwise settles the debt or reduces the debt (and intended to do so).

Conduct risking accrued benefits is also a new criminal offence defined as an "… act or course of conduct that detrimentally affects in a material way the likelihood of accrued scheme benefits being received" without reasonable excuse and where the person committing the act knew or ought to have known that that the act or course of conduct would have that effect.

These two offences mirror the existing triggers for a contribution notice. Both new offences can result in an unlimited fine and/or up to seven years in jail. Alternatively, the Regulator can deal with similar transgressions by means of financial penalties of up to £1m.

Notifying the Regulator of significant corporate events

The notifiable events legislation impacting PPF-eligible schemes is expanded, requiring employers to give notice to the Regulator of certain events, material changes to the effect of such events and the non-occurrence of these events. These notices must be given "as soon as reasonably practicable" and a regulation-making power is introduced to enable notification to be required from a prescribed earlier date. As for the events themselves, although the detail will be in the regulations, according to an impact assessment the events will be as settled following the June 2018 consultation.

The Act also includes the provisions for "statements of intent" that employers must supply to the Regulator at the same time as notifying three particular events: The impact assessment suggests that these events are as settled following the June 2018 consultation – ie the sale of the controlling interest in a sponsoring employer, the sale of the business or assets of a sponsoring employer, and the granting of security in priority to scheme debt. The statements of intent, which must also be sent to the trustees, describe the event, any adverse effect of the event on the scheme, any steps taken in mitigation and any communication with the trustees.

Our viewpoint

Criminal offences

The new criminal offences replace the "wilful or reckless behaviour in relation to a pension scheme" offence that seemed to have been settled on in 2019.

These new offences are much wider in scope, although the Government has said that it is not its intention to interfere with "routine business activities". Many individuals could also be drawn within the ambit of the second offence, including trustees and their advisers.

Concerns expressed by a number of Parliamentarians have resulted in a commitment for the Regulator to consult on guidance explaining its approach to prosecuting these new offences with such guidance being finalised before the provisions are commenced. However, the wording of these new offences, as presented by the Government to Parliament, continues to stand, with the potential for them to have a chilling effect on corporate activity.

Notifiable events legislation

That the Government is going ahead with the adjustments to the notifiable events legislation and introducing statements of intent in respect of certain corporate events is no surprise. But it will be some time before we find out how onerous these new requirements will be and to gauge their impact on corporate activity. One thing is for sure – employers will need to engage earlier with trustees about any corporate activity with a potential impact on the DB scheme they sponsor.

Other Regulator powers

The Regulator's powers are expanded in the area of interviews and inspection of premises. A fixed and escalating penalty regime is introduced where information requests and the like are not complied with.

Financial penalties are potentially imposed where a person has "knowingly or recklessly provided the Regulator with information which is false or misleading in a material particular" in connection with specified obligations. The same sanction potentially applies where a person has acted similarly towards the trustees of a DB scheme in relation to specified obligations they have to the trustees.

New provision is made for financial penalties to be meted out by the Pensions Regulator of up to £1m, with the possibility of regulations delivering higher limits. Aimed at corporates, the fine can be personal.

DB scheme funding

Trustees will need to agree with the employer a long-term "funding and investment strategy" which must in particular specify the funding level that the trustees intend the scheme to have achieved by a "relevant date(s)" and the investments they intend the scheme to hold at that time. This strategy will be constrained by regulations linked to the new DB funding code.

Having settled this strategy, the trustees will need to prepare a written statement of this strategy which also must contain certain supplementary matters. These include the extent to which the trustees think the strategy is being successfully implemented (and, where not, proposed steps to remedy this), the main risks faced by the scheme in implementing the strategy and how the trustees intend to mitigate or manage them, and the trustees' reflections on any relevant significant decisions taken by them in the past. This "statement of strategy" must be signed by the chair of trustees. Employers need to be consulted but do not need to agree the statement.

Other changes include the following:

- The scheme's technical provisions must be determined in a way that is consistent with the scheme's funding and investment strategy as set out in the statement of strategy.
- The trustees must send all scheme funding valuation reports to the Regulator after they have received them.
- Regulations are likely to set out the matters to be taken into account or the principles to be followed in determining whether a recovery plan is "appropriate".

Our viewpoint

Other Regulator powers

None of these new powers are a surprise – in some cases what is surprising is that the Regulator did not already have such powers. But their existence means that the Regulator is now equipped to act more forcefully.

DB scheme funding

The proposed changes to the primary legislation cover only part of a sweeping reform of the regulation of DB scheme funding with potentially significant impacts on the current flexibility for negotiating journey plans and technical provisions and determining investment strategies.

The as yet unseen regulations will provide the means by which the Regulator will be able to impose its will on schemes falling outside its 'fast track' or 'bespoke' parameters. The next significant step will be when the Regulator issues its second consultation on its new approach – this may take place in the third quarter of 2021. We currently believe that the new regime is not likely to operate until valuation dates falling on or after 31 March 2022.

Our guide to the Pension Schemes Act 2021
Continued

Climate change

The Act provides for certain occupational pension schemes to address climate change risks and opportunities. Details will be set out in regulations, but they include:

- reviewing the exposure of the scheme to certain risks, determining a strategy for managing scheme exposure to climate change risks, setting targets relating to the scheme's exposure to climate change risks, and monitoring performance against such targets; and
- publishing certain information relating to the effects of climate change on the scheme.

On both aspects, trustees will need to have regard to statutory guidance. Failure to comply with the regulations could result in the Pensions Regulator issuing compliance notices and then penalty notices, including referring the penalty notice to a Tribunal – with penalties being no more than £5,000 for an individual and £50,000 in any other case. However, a mandatory penalty will apply only where there has been wholesale non-compliance.

Related to this the DWP has consulted on proposals to require large schemes to disclose their approach to managing climate risks and opportunities from 1 October 2021, in line with the recommendations of the Taskforce on Climate-related Financial Disclosures.

Our viewpoint

Climate change

The DWP's proposals are detailed and well thought through, providing a clear direction of travel. If implemented as proposed, we expect they will prompt significant action by larger schemes. They will also define good practice to be followed by smaller schemes.

Pensions dashboards

A number of sections of the Act set out what constitutes a "qualifying pensions dashboard service" before going on to enable regulations to be set that will require occupational pension schemes (of any type) to supply data to the dashboard providers, with the threat of sanction from the Pensions Regulator for failing to do so. The FCA is also empowered to set rules to require personal and stakeholder pension providers to supply data. Schemes may need to provide generic scheme information and "information as regards the position of an individual in relation to the scheme".

The Money and Pensions Service (MaPS) is required to deliver a pensions dashboard.

Separately MaPS has been making progress on a number of aspects of the dashboard including the data requirements – and it now seems that the 'go live' date will be in 2023.

Pensions dashboards

It is now a racing certainty that the dashboard project will be delivered, with all that this means for schemes in their role of sourcing and contributing clean data. This may prove to be a challenge for some DB schemes.

Other provisions

Collective money purchase schemes

A large part of the Act is devoted to introducing legislation to allow Collective Money Purchase schemes to come into existence. The Act introduces an authorisation and supervision framework intended to allow the proposed Royal Mail scheme to come into existence with most of the detail to be set out in regulations.

Further detail about the Act's provisions in respect of these schemes is set out in the Appendix.

Transfer values

The legislation governing the right to take a "cash equivalent" is constrained with the objective of enabling trustees who have doubts whether the destination scheme is genuinely occupational by reason of the individual's new "employment", to deny a transfer to that scheme. Details will be spelt out in regulations.

The right to take a cash equivalent is potentially further constrained by regulations enabling trustees to refuse to pay a transfer where there are "red flags" indicating potential scams. The regulations will also require members in certain situations to obtain information or guidance from sources such as MaPS and evidence this to the trustees, and for the trustees not to process the transfer until this has happened. Finally, the regulations may also specify that members are to be informed of these requirements as part of the transfer process.

The Pension Protection Fund

A very short section expands the effect of changes made by regulations to overcome the Beaton case in relation to fixed pensions granted on transfer in. The regulations, which are currently effective only for schemes entering assessment since 2 October 2018, will be deemed to always have had effect.

Our viewpoint

Transfer values

This is a much-needed reform to protect, from pension scammers, those contemplating transferring their benefits. It is good to see significant cross-party and industry working to develop the necessary regulations, potentially involving "red flags", which hopefully will come into force by mid-2021. However, it may be a challenge to specify the red flags to successfully supress fraudulent activity.

Final word

The Act represents the culmination of a substantial amount of policy work bringing forward most of the measures discussed in the March 2017 Green Paper and the February 2018 White Paper. But there are some significant omissions – most notably in relation to the promise to set up a formal authorisation and supervision regime for "superfunds" – the new DB consolidation vehicles – although work on this continues and the possibility of it being contained in a future Pensions Bill later in this Parliament has been floated by the Pensions Minister.

Other areas that have failed to make the cut include adjustments to the GMP conversion legislation in order to facilitate its use as an equalisation solution and changes to the Pensions Ombudsman's powers and duties in order to reflect his expanded role and new ways of working.

But perhaps most significantly of all, those measures in the Act impacting DB sponsors were conceived in a largely benign economic environment. The Government may not be in a hurry to implement all of them whilst the economic background remains very challenging. And for those that are implemented there may need to be some watering down.

Appendix

Collective money purchase schemes – the detail

How CMPs will work

In their simplest forms, Collective Money Purchase schemes (CMPs) work by providing "qualifying benefits" whose value is periodically balanced with the value of the pension scheme assets. In the Royal Mail scheme, this is achieved in all but extreme cases by adjusting the level of future pension increases both before and after retirement – so if experience is good all future increases go up and if it is bad they go down. If funding gets really bad, benefits can be cut and potentially the scheme can be forced to wind up.

If the scheme wants to provide any guaranteed benefits, such as guaranteed lump sums on death, they have to be provided by a completely separate section of the scheme with no cross-funding.

Only single employer schemes, or those run by "connected" employers within the same group, are allowed. Public service employers are excluded, but there is the facility for regulations to extend the definition of "qualifying schemes" to multi-employer schemes and Master Trusts.

Transfers out of the scheme are to be allowed. Regulations will set out further rules on elements such as the calculation of benefits, member communications, and the significant events that should be notified to the Regulator.

Authorisation, benefit calculation and regulation

All CMPs need to be authorised by the Pensions Regulator, with applications meeting the following authorisation criteria:

- Certain key figures in the scheme, including the person establishing the scheme and the trustees, meet "fit and proper persons" requirements.
- The trustees confirm in a "viability report" the design of the scheme and why they consider it to be sound. This report will be reviewed annually. A scheme actuary is required to advise on the method and assumptions used, provide a "viability certificate" confirming the design of the scheme is sound and carry out the annual valuations assessing the balance between assets and liabilities.
- The scheme has an adequate "continuity strategy", which outlines how it could react to one of a number of "triggering events", including employer insolvency, scheme closure or wind up and the Regulator shutting down the scheme.
- The scheme should be financially sustainable, including by having sufficient resources to cover the costs of set up and running the scheme.
- The communications are adequate so that correct and not misleading information is sent to members, prospective members and survivors.
- The scheme has effective systems and processes to ensure the scheme runs smoothly.

The Pensions Regulator will keep a list of all authorised CMP schemes and has quite wide-ranging powers to take steps it sees appropriate if something goes wrong. It can call a new valuation or issue a "risk notice" if it is concerned the scheme might breach the authorisation criteria and require the trustees to submit proposals for fixing the issues by a specified date. In extreme cases, withdrawal of authorisation is possible.

Triggering events

If a triggering event does occur, a scheme has one of the following three continuity options:

- Discharge of liabilities and winding up – either by transferring to another CMP, a DC Master Trust or other specified scheme.
- Resolving the triggering event (eg, on employer rescue if it became insolvent).
- Conversion to closed scheme, with Regulator approval. This decision cannot be reversed.

In certain scenarios, the trustees must pursue the first option. Under any of the above options, the trustees must generally submit an "implementation strategy" to the Regulator setting out how members' interests will be protected, which the Regulator should approve, followed up by regular reporting after the event.

Our viewpoint

The Act provides a sensible-looking framework for Collective Money Purchase schemes to sit within. Whilst employers interested in the concept don't have enough information to set up a scheme at this stage, they do have a good steer as to where the Government is going, helped by the publication of early drafts of the regulations.

Want to find out more?

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