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pensions law group

CLEAR VIEWS

The Pension Schemes Act 2021

A guide for anyone who deals with defined benefit pension schemes

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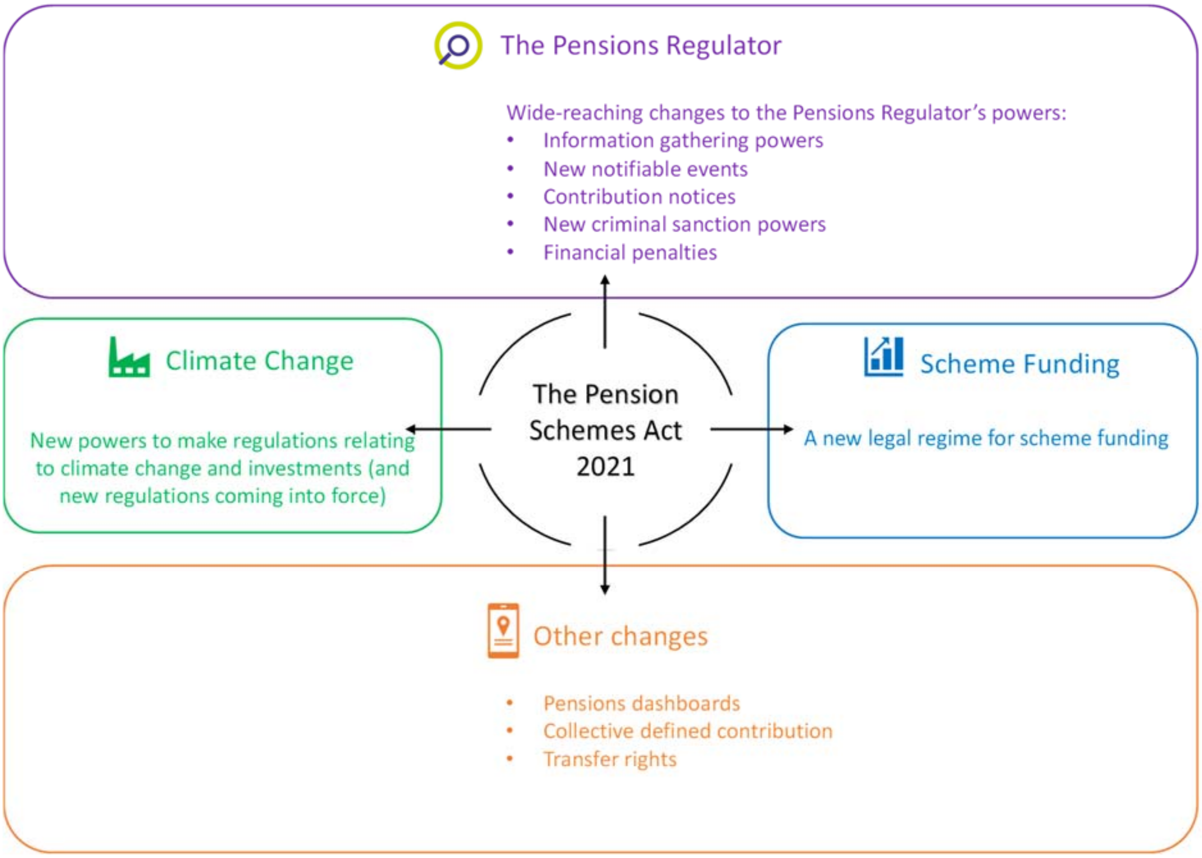
OVERVIEW

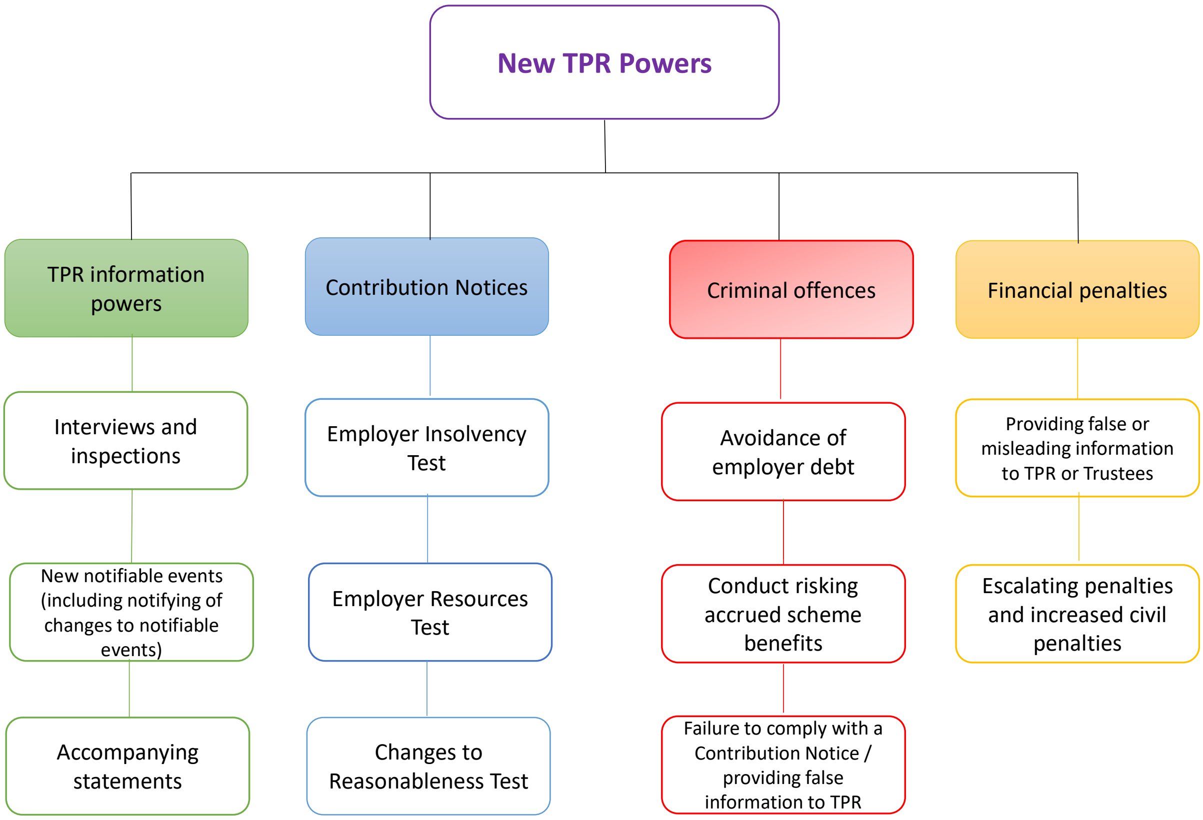
The Pension Schemes Act 2021 (the **Act**) has brought about some fundamental changes to the regulation of pension schemes which will be most acutely felt in the sphere of defined benefits. It also provides the framework for further change through the implementation of secondary legislation.



THE POWERS OF THE PENSIONS REGULATOR

The most controversial area of change has been the extension of the powers of The Pensions Regulator (the **Regulator**) - in particular, the widely-drafted and potentially far-reaching criminal offences that will now exist. **These have the potential to catch a wide range of parties including sponsors, trustees, advisers and lenders.**

The Regulator has been given additional powers at every stage of the process; from the initial information gathering stage to the point where that information gives cause for concern.



Information gathering powers

Interviews and inspections

Since 1 October 2021, the Regulator has had additional powers to require employers, trustees and professionals to attend an interview. The Regulator's powers to inspect certain premises have also been extended.

Non-compliance is a criminal offence and can attract a fine of a maximum of £50,000. An escalating penalty notice of up to £10,000 per day can also be issued in respect of non-compliance with interview requirements.

Notifiable Events

The notifiable events regime requires certain defined benefit sponsor-related or scheme-related events to be notified to the Regulator. The regime essentially works as an early warning system allowing the Regulator to monitor and react to any events that could be seen as threatening the funding position of a pension scheme.

Draft Regulations[1] propose to change the notifiable events regime. The DWP intends to bring the Regulations into force on **6 April 2022.** The draft Regulations expand:

- the events that require notification;
- the time period over which the Regulator must be notified; and
- the amount of information which needs to be provided to the Regulator.

Additional events to be notified

The draft regulations introduce two new notifiable events:

- a "decision in principle" by an employer to sell a material proportion of its business or assets. A "material proportion" of the business or assets is defined as one that accounts for more than 25% of the employer's annual revenue or gross value of its assets (as appropriate). Given concerns that employers may attempt to circumvent this by breaking transactions down into small components, transactions will be tested either on their own or taken together with any other sales decided upon within the previous 12 months; and

- a "decision in principle" by an employer to grant or extend certain security over its assets which will be ranked above the pension scheme on an insolvency.

The timing of notification

The new notifiable events also bring forward the time from when certain notification obligations apply. The new events (and the existing corporate sale event, as amended by the draft Regulations) are triggered once a "decision in principle" has been reached. This is defined as the stage before any negotiations have even been entered into and is intended to provide the Regulator with an earlier warning compared to current notifiable events.

[1] The Pensions Regulator (Notifiable Events) (Amendment) Regulations 2021

Additional information to be notified

The draft Regulations provide that new notice and statement requirements will apply to the two new notifiable events listed above, as well as to the current corporate sale notifiable event. These obligations bite once the main terms of those events have been proposed. For these three notifiable events there would therefore be a two-stage process:

Stage 1 Initial notification once a "decision in principle" has been made

Stage 2 Notice and statement requirements once the main terms have been proposed

Notice requirement	Statement requirement
Give notice to the Regulator of: • the notifiable event; • any material change in, or the expected effect of, the notifiable event; and • if the notifiable event is not going to, or does not, take place.	Give a statement to the Regulator explaining: • the event and, where relevant, the main terms proposed; • the adverse effects on the pension scheme; • the adverse effects of the event on the employer's ability to meet its legal obligations to support the pension scheme; • steps taken to mitigate the adverse effects; and • any communication with the trustees of the eligible scheme about the event.

Sponsors will therefore need to consider the impact of any proposed transaction on their defined benefit pension scheme both from the outset of the transaction and then on a continuing basis. Early communication and open dialogue with trustees will be key and both trustees and sponsors will need to consider mitigation and keep clear records and minutes of discussions and decisions.

Increased fines for failure

The Act also introduces heavy penalties for a failure to supply the Regulator with information:

Offence	Penalty
A party failing to notify the Regulator of an event which is a notifiable event under legislation, or a failure to comply with new notice and statement requirements in respect of prescribed notifiable events (once these are in force).	Fine of up to £1 million
Knowingly or recklessly providing the Regulator or a trustee with false or misleading information in certain circumstances.	Fine of up to £1 million

These increased penalties came into force on 1 October 2021.

Extension of contribution notice regime

New tests

Under its so-called "moral hazard" powers, the Regulator has the power to pierce the corporate veil and impose liability for defined benefit pension scheme deficits on parties who are not necessarily sponsoring employers under the scheme. One power allowing the Regulator to do this is the issue of a contribution notice, requiring the party to whom it is issued to pay money into the scheme.

Since 1 October 2021, the Act has widened the circumstances in which the Regulator can impose a contribution notice on a party by including an additional two grounds:

- The employer insolvency test – this allows a contribution notice to be issued where a person was a party to an act or failure to act that materially reduced the amount of the section 75 (or buy-out) debt likely to be recovered by the pension scheme. For this test to be satisfied, the value of the scheme's assets must be less than its liabilities, both as estimated by the Regulator.

  A defence is available where, before becoming a party to the act or failure to act, the party gave due consideration to the extent to which the act or failure might have this effect and either:

  (i) reasonably concluded that the act or failure to act would not have this effect or, if they did not conclude this,
  (ii) took all reasonable steps to eliminate or minimise the potential for the act or failure to have such an effect.

  This requires the party to have made the enquiries and done the other acts that a reasonably diligent person would have made or done in the circumstances.

- The employer resource test - this test will be satisfied if there is an act or failure to act which reduced the value of the resources of the employer in the scheme and the reduction was a material reduction relative to the estimated section 75 (or buy-out) debt in relation to the scheme.

  A defence is available if, before becoming a party to the act or failure to act, the party gave due consideration to the extent to which the act or failure to act might have this effect and either:

  (i) reasonably concluded that the act or failure to act would not have this effect or, if they did not conclude this,
  (ii) took all reasonable steps to eliminate or minimise the potential for the act or failure to act to have such an effect.

  This requires the party to have made the enquiries and done the other acts that a reasonably diligent person would have made or done in the circumstances.

Regulations[23] set out what the resources of the employer are for the purposes of this test and how the value of those resources is to be determined, calculated and verified. The Regulator has the power to determine the effect of the act or failure on the value of the resources of the employer.

When imposition of a contribution notice will be reasonable

Under any contribution notice test (whether new or existing), a contribution notice can only be issued if it is reasonable to do so. Legislation sets out a number of matters that the Regulator can take into account when considering if the test for "reasonableness" has been satisfied. This list has been extended by the Act to include a failure to notify the Regulator of an event that was a notifiable event under legislation and the effect of the act or failure to act on the value of the assets or liabilities of the pension scheme.

Regulator guidance

In its draft Code of Practice 12, which is now in force, the Regulator provides examples of situations which may allow it to issue a contribution notice under either the two new tests, or the existing material detriment test. These examples are:

- Sponsor support being removed, substantially reduced or becoming nominal;
- The weakening of the pension scheme's creditor position;
- Some instances of paying a dividend or a return of capital by the sponsoring employer; and
- Payments favouring other creditors of the employer over the pension scheme where no such sums are then due to those creditors.

It is perhaps understandable why some in the pensions industry fear that these new powers could have an impact on business recovery and, in particular, on the payment of dividends where this could be viewed as "value leakage".

Increased penalties for non-compliance

A failure to comply with a contribution notice without a reasonable excuse is:

- a criminal offence punishable by a fine; and
- a civil offence with a penalty of up to £1 million.

[3] The Pensions Regulator (Employer Resources) Test Regulations 2021

New criminal offences

The offences

The most controversial element of the Act is the creation of new criminal offences. These came into force on **1 October 2021.**

Offence	Penalty
Avoidance of employer debt - where a person was a party to an act of deliberate failure to act the main purpose of which was to: • prevent the recovery of the whole or any part of a debt due by an employer to the scheme under section 75; • prevents such a debt becoming due; • compromise or settle such a debt; or • reduce the amount of such a debt that would otherwise become due. The person must have intended the act to have such an effect and not have a reasonable excuse for acting in that way.	A fine and/or imprisonment for up to 7 years
Conduct risking accrued scheme benefits – where a person acts or deliberately fails to act in a way that detrimentally affects in a material way the likelihood of accrued scheme benefits being received. The person must have known or ought to have known that the act would have had that effect and cannot have a reasonable excuse for engaging in that conduct.	A fine and/or imprisonment for up to 7 years

If someone aids, abets, counsels or procures another person to commit one of these offences without a reasonable excuse for doing so, they can also be found guilty of the offence.

Concern in the industry around these offences has arisen as a result of their very wide drafting. They also rely heavily on inherently uncertain concepts of "reasonableness" and this will make it very difficult to give definitive advice on the law. Ultimately the true extent of these offences will come down to the way in which the Regulator and the courts interpret these provisions in practice.

The scope of the offences is also not limited to the sponsor of a defined benefit scheme or its corporate group in the way that the Regulator's moral hazard powers are. Rather, almost any party could, in theory, be caught by these new offences - from sponsors and trustees through to lenders and advisers.

Whilst the criminal offences do not have retrospective effect, the Regulator has confirmed that, when considering someone's intention, it may take account of acts before 1 October 2021 when determining if an offence has been committed. There is also no time limit bar to prosecution for these offences.

The following events could, in theory, fall under these new offences:

Avoidance of employer debt	**Conduct risking accrued scheme benefits**
Flexible apportionment arrangement (prevents a debt becoming due)	Trustees do not use a contribution setting power to call in full buy-out deficit immediately
Keeping active members in the scheme (prevents a debt becoming due)	Operating a defined benefit scheme open to accrual (liabilities increase)
	Lender enforcing security
	Successful litigation against the employer

It would then be down to relying upon the uncertain tests of intention and reasonableness to determine if an offence had been committed.

From a trustee's perspective, public policy does not allow liability for criminal wrongdoing to be excluded and we therefore expect to see an increase in trustees seeking legal advice as to whether they can rely on indemnities and/or seek insurance in this area.

The Regulator's criminal offences policy

In its criminal offences policy, the Regulator provides guidance on its approach to the investigation and prosecution of the new criminal offences. The Regulator has attempted to alleviate concerns by acknowledging that, whilst the offences are broadly drafted:

> *"the Regulator do[es not] intend to prosecute behaviour which we consider to be ordinary commercial activity. We will investigate and prosecute the most serious examples of intentional or reckless conduct that were already within the scope of our CN [contribution notice] power, or would be in scope if the person was connected with the scheme employer".*

The Regulator will look at three factors when considering if someone had a reasonable excuse:

- The extent to which the detriment to the scheme was an incidental consequence of the act or omission;
- The adequacy of any mitigation provided to offset the detrimental impact; and
- Where no, or inadequate, mitigation was provided, whether there was a viable alternative which would have avoided or reduced the detrimental impact.

Where someone is looking to rely upon a reasonable excuse to show that an offence has not been committed, the Regulator expects the basis for a reasonable excuse to be clear from contemporaneous records such as minutes, correspondence and written advice. It is therefore crucial that those involved with defined benefit pension schemes keep accurate and timely records of decisions made, discussions held and advice received. Scheme mitigation will also become increasingly important.

New civil liability

To echo the new criminal offences, the Act also introduces two new civil offences from **1 October 2021** which also carry hefty fines:

Cause of action	Penalty
Avoidance of employer debt	Fine of up to £1 million
Conduct risking accrued scheme benefits	Fine of up to £1 million

CHANGES TO DEFINED BENEFIT FUNDING REGIME

Under provisions which are not yet in force, trustees of defined benefit schemes will be required to determine and keep under review a written funding and investment strategy for ensuring that benefits under the scheme can be provided over the long-term.

Trustees must also, in consultation with the employer, state the extent to which the strategy is being successfully implemented and, where it is not, what steps are being taken to remedy the position. The main risks faced by the scheme in implementing the strategy must also be set out, together with how these will be mitigated. Trustees will also need to reflect on any significant past trustee decisions that are relevant to the strategy.

A scheme’s technical provisions must be calculated in a way that is consistent with the scheme’s funding and investment strategy.

Regulations will set out further details of these requirements and the Regulator hopes that the new funding regime will be in place for **schemes with actuarial valuations from December 2022**.

CLIMATE CHANGE REPORTING AND DISCLOSURE REQUIREMENTS

Regulations[4] made under powers in the Act and which came into force on **1 October 2021** impose requirements on pension scheme trustees to secure effective governance of the scheme with respect to the effects of climate change. These regulations:

- require information relating to the effect of climate change on the scheme to be published; and
- impose penalties to ensure compliance with the above.

They mandate the recommendations set out by the Task Force on Climate-related Financial Disclosures (**TCFD**) for larger occupational pension schemes, including master trusts and collective money purchase schemes. They place governance and disclosure obligations aligned with recommendations made by the TCFD into pensions law.

Which schemes do the new requirements apply to?

Scheme type	Deadline for governance requirements	Deadline for disclosure requirements
Schemes with £5 billion or more in assets Authorised master trusts Collective money purchase schemes	From 1 October 2021	Earliest of: (i) within 7 months of first scheme year to end after 1 October 2021, and (ii) 31 December 2022
Schemes with £1 billion or more in assets	From 1 October 2022	Earliest of: (i) within 7 months of first scheme year to end after 1 October 2022, and (ii) 31 December 2023
Schemes with less than £1 billion in assets	The government will look to review the position in 2024 and consult again before extending the requirements to other schemes	

What are the new governance and disclosure obligations?

The governance and disclosure obligations largely focus upon trustees assessing and understanding climate-related risks and opportunities in respect of pension scheme assets, liabilities, investments and, where appropriate, funding strategies.

The DWP has published statutory guidance to assist with compliance with these new requirements.

For more information on this topic, please see our extensive ESG guide here.

[4] The Occupational Pension Scheme (Climate Change Governance and Reporting) Regulations 2021

RESTRICTIONS ON TRANSFERS OUT

The Act provides for the making of Regulations to limit the circumstances in which a statutory transfer out can be made. Draft regulations[5] have been made which attempt to reduce the risk of transfers being made to scam arrangements. These are not yet in force, but it is expected this will happen sometime in **Autumn 2021.**

The draft regulations require:

- trustees to confirm that the transfer is to one of a number of types of receiving scheme which are low risk (for example, public service schemes, authorised master trusts and personal pension schemes authorised by the FCA).
- If the transfer is not to a "safe" scheme, a member will need to provide further information. This includes:
    - providing evidence of an employment link between the member and the receiving scheme; or
    - if a transfer is to a QROPS, evidence that the member is resident in the same jurisdiction as the QROPS.
- If these conditions are not satisfied, the trustees must determine if any "red flags" (as listed in the regulations) are present. If they are, the transfer cannot not proceed.

[5] The draft Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021

COLLECTIVE MONEY PURCHASE SCHEMES

What are they?

The Act establishes a framework for schemes to provide collective money purchase benefits. A collective money purchase benefit is one:

- that can be provided out of the available assets of the scheme; and
- under the rules of the scheme, whose rate or amount is subject to adjustment designed to achieve a balance between the value of available assets of the scheme and the amount expected to be required for the purpose of providing benefits under the scheme for members of the scheme collectively.

In other words, unlike with defined benefit pensions, collective money purchase benefits cannot exceed the available assets in the scheme, and the targeted benefits which are to be provided can be adjusted in order to balance what members are expecting to receive with what the scheme can actually afford to provide.

Any scheme providing a collective money purchase benefit must be:

- an occupational pension scheme; and
- used by only a single employer or two or more employers that are connected with each other. The implication, therefore, is that master trusts could not provide such benefits.

What does the framework provide?

Much like the master trust regime, the Act requires collective money purchase schemes to seek (and receive) authorisation from the Regulator in order to operate. The Regulator must decide within six months of an application whether to grant authorisation. A list of authorised schemes will then be published.

The Regulator can withdraw a scheme’s authorisation if it ceases to meet the authorisation criteria. The schemes will, therefore, be subject to the Regulator's ongoing supervision.

PENSIONS DASHBOARDS

The Act also provides for a regime to introduce pension dashboards.

A pensions dashboard is an "*electronic communications service by means of which information about pensions may be requested by, and provided to, an individual*…"

For a pensions dashboard to be "qualifying" it will have to meet certain requirements, the details of which will be set out in regulations.

Regulations may also impose requirements on trustees of occupational pension schemes to provide certain information regarding the scheme via a dashboard service.

Information that is likely to be required to be presented on the dashboards will include the administration and finances of the pension scheme, the rights and obligations that arise under the scheme and the pension and other benefits which are likely to be accrued by a member of the scheme.

COMMENT

The extension of the powers of the Regulator is the area of the Act that has gleaned the most attention in the industry and in the press, in particular the new criminal sanctions. Given the very broad drafting of the offences, the wide pool of potential "offenders" and the need to rely on uncertain concepts such as "reasonableness" it is understandable to see why this is the case. With no exclusions for trustees, those acting in their professional capacities or lenders, the potential impact of the offences is a cause for concern. However, the Government and the Regulator have been keen to stress that the intention is not to prosecute usual corporate activity but, rather, those who are reckless in relation to defined benefit schemes. We hope that practice will bear this out once enforcement of the offences begins.

One development that has attracted less commentary is the proposed extension of the notifiable events regime. This development should not be understated and is very likely to have a bigger impact on sponsors and trustees in the business-as-usual context. The regime will catch most corporate transactions and refinancing. Defined benefit pension schemes and the impact of any transactions on them should therefore be at the forefront of sponsors' minds from the outset. Trustees should also expect their involvement in corporate activity to increase.

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