STEPHENSON HARWOOD

pensions law group

CLEAR VIEWS

Pensions in 2021 – the top six topics to watch

OVERVIEW

2020 was not the year that any of us expected. With Brexit and Covid-19 occupying much of the Government's time, it is little surprise that some of the developments that were expected to occur in the pensions world did not materialise. As a result, we expect 2021 to be a busy year for the pensions industry, with changes on the horizon that sponsors, trustees and pensions professionals will need to get to grips with.

The key areas on our radar where we expect further development and activity this year are:

1. The Pension Schemes Bill
2. Scheme funding code for defined benefit schemes
3. GMP equalisation and transfers out
4. Defined benefit superfunds
5. Consolidation of defined contribution schemes
6. New obligations regarding environmental, social and governance (**ESG**) factors

The Pension Schemes Bill

It was widely anticipated in the pensions industry that the Pension Schemes Bill would receive Royal Assent at the end of 2020. However, it is perhaps unsurprising it did not get over the line with much of the Government's time taken up with Brexit and Covid-19. We therefore await the Bill's passage into law sometime this year. Some of the key changes the Bill would introduce include:

Additional powers for the Pensions Regulator and new offences

This is one of the major impacts that the Pension Schemes Bill will have and is of practical interest to sponsors and those involved in defined benefit pension schemes.

The Pensions Regulator will be given additional powers - for example, the circumstances in which it can impose contribution notices will be extended. The notifiable events regime will also be expanded and made more prescriptive. In addition, new civil and criminal penalties will be imposed for certain actions. These include undertaking any conduct that puts accrued scheme benefits in defined benefit pension schemes at risk, avoiding an employer debt in a defined benefit pension scheme and failing to comply with a contribution notice. The sanctions include up to seven years' imprisonment and £1 million in fines.

A framework for the establishment and administration of collective defined contribution (**CDC**) pension schemes

Under CDC schemes, the rate or amount of the benefit a member receives is subject to an adjustment which is 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 to or in respect of the members collectively.

In other words, unlike with defined benefit pensions, CDC 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.

Under the proposed framework in the Pension Schemes Bill, CDC schemes will need to satisfy specific criteria in order to achieve authorisation. The Pensions Regulator will then be responsible for the ongoing supervision of these schemes.

It remains to be seen how the CDC market will develop once this framework is in place.

Changes to defined benefit scheme funding requirements

The Government is keen to improve defined benefit scheme funding in order to protect members' pensions better. As part of this, 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 state the extent to which the strategy is being successfully implemented and, where it is not, what steps they are taking to remedy the position. The main risks faced by the Trustees 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.

Further information on the contents of the Pension Schemes Bill can be found in our briefing on the topic which was produced when the Bill was published during the last Parliament.

Scheme funding code for defined benefit schemes

As part of the policy of improving defined benefit scheme funding - and given the proposed changes to scheme funding requirements under the Pension Schemes Bill - the Pensions Regulator consulted on the principles for a new defined benefit funding code last year. During this consultation the Regulator proposed a twin-track compliance approach to valuations under either a 'fast-track' or 'bespoke' approach to the valuation process. Trustees would need to meet certain fast-track guidelines in order to use the straightforward, but prescriptive, fast-track approach. Otherwise, there would be a bespoke option that will offer greater flexibility.

In its interim response to this consultation, the Regulator noted that there was general support for the approach proposed in the consultation, although some concerns had been raised. These included concerns that schemes that use the fast-track approach may end up 'levelling down'. There could also be an increased evidential burden for schemes submitting a bespoke valuation.

Once it has had a chance to consider all the comments provided to the first consultation and the Pension Schemes Bill is finalised, the Regulator expects to issue a second consultation in the second half of 2021. This will include the draft code of practice which will need to be consistent with the Pension Schemes Bill requirements.

GMP equalisation and transfers out

The most recent instalment of the *Lloyds* cases dealt with the question of whether past transfers-out have to be topped up to equalise any transfer payment that did not equalise GMPs.

The case confirmed that top-up payments need to be made from the transferring scheme to the receiving scheme in respect of any past **statutory** transfers-out. Trustees cannot rely on statutory discharges in respect of past statutory transfers that did not take account of GMP equalisation. The position is, however, different for non-statutory transfers-out which are considered valid and binding unless and until they are set aside by the court.

In contrast, GMP equalisation for members who transferred out by way of a bulk transfer remains the responsibility of the receiving scheme.

We expect this year to see continued activity by schemes undertaking their GMP equalisation exercises, including in respect of any past statutory transfers-out or received bulk transfers-in.

For more information on the most recent *Lloyds* decision regarding past transfers-out, please see our briefing.

Defined benefit superfunds

Defined benefit superfunds are one method by which defined benefit schemes can de-risk, generally at a price that is much more affordable than buy-out. Transferring to a superfund involves transferring the defined benefit scheme to a third party provider and allows the link between the sponsoring employer(s) and the scheme to be severed.

We are currently awaiting a legislative regime to govern this area. The Pensions Regulator has, in the meantime, set out its own regime to regulate matters. Before a scheme can transfer to a superfund, clearance must be obtained from the Pensions Regulator. Clearance will only be granted if the scheme meets three gateway principles:

- The existing pension scheme cannot afford to buy out now
- The existing pension scheme has no realistic prospect of buy-out in the foreseeable future given potential employer cash contributions and the insolvency risk of the employer
- A transfer to the chosen superfund must improve the likelihood of members receiving full benefits

The Pensions Regulator's guidance also sets out the process and timescales for certain steps.

Now there is a regulatory framework in place, it is possible that transfers to superfunds will take off this year and will become an increasingly common way for defined benefit schemes which meet the gateway principles to de-risk.

Please see our superfunds brochure for more detail on this topic. Our market-leading transfer specialists are also on hand to provide further information and advice.

Consolidation of defined contribution schemes

Last year the Government consulted on changes to legislation to accelerate consolidation in the defined contribution market. Under the proposals, trustees of schemes with assets below £100 million will be required to assess key elements of the value achieved by their scheme, taking into account costs and charges, investment returns and various elements of governance and administration. If they do not present value for members, this must be reported in the scheme return. If the assessment shows members would receive better value in a larger scheme, the trustees are expected to wind up the defined contribution scheme and consolidate it into a larger scheme (for example, a master trust).

The proposed amendments would come into force on 5 October 2021.

As a result of these changes, we expect an increase in transfers of smaller defined contribution schemes to master trusts. Our transfer specialists are on hand to advise in this area and assist any schemes that want to get ahead on this point.

New obligations regarding environmental, social and governance (**ESG**) factors

ESG considerations have increasingly been on the radar when it comes to pension schemes. Recent legal changes have seen obligations placed on trustees to consider ESG factors when preparing their statement of investment principles and implementation statements. We expect the area of ESG to continue to develop in 2021 for both occupational and personal pension schemes.

The Pension Schemes Bill contains powers for regulations to be made imposing requirements on trustees regarding climate change. Last summer the DWP published a consultation suggesting that one use of this regulation-making power would be to enable recommendations set out by the Task Force on Climate-related Financial Disclosures (**TCFD**) to be mandated for certain schemes. That would place governance and disclosure obligations in line with the recommendations made by TCFD into pensions law. The obligations largely focus upon trustees assessing and understanding climate-related risks and opportunities to pension scheme assets, liabilities, investments and, where appropriate, funding strategies.

The proposed new requirements would initially apply to schemes with £5 billion or more in assets, master trusts and CDC schemes from 1 October 2021. They would then be extended. Penalties would apply for non-compliance.

With regards to FCA-regulated pension schemes, the FCA has announced that it is planning to consult early this year on potential client-focused TCFD-aligned disclosures by these pension schemes.

This year could therefore see both occupational and personal pension schemes (of certain sizes at least) being required to disclose against TCFD requirements.

Our dedicated ESG team are available to assist with any queries you may have. More information, including further potential developments in this area, is available in our extensive brochure on this topic.

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