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NEWSLETTER

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PENSIONS BULLETIN

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In this month's Pensions Bulletin, we cover:

1. A review by the Pensions Regulator (TPR) of the first tranche of trustees' reports on climate risk, highlighting areas where reports failed to meet the detailed requirements of the Regulations and statutory guidance.
2. The Pensions Scams Industry Group has issued a new version of its Code of Good Practice on Pension Scams. The guide points out areas where the Conditions for Transfers Regulations 2021 conflict with TPR guidance and the risks of relying on clean lists.
3. HMRC has updated its guidance for scheme administrators on taxation of certain lump sum death benefits following the changes to pensions tax allowances announced in the Budget.
4. TPR has issued guidance for trustees and employers on equality, diversity and inclusion.
5. TPR is embarking on a regulatory initiative to check that trustees of DC schemes with assets under management of less than £100m are complying with the requirement to complete a Value for Members assessment.
6. The exemption for pension funds from the requirement to clear "over-the-counter" derivatives, due to end on 18 June 2023, will be extended for another two years.

We include our regular watch list of current and future developments.

THE PENSIONS REGULATOR'S REVIEW OF CLIMATE RISK REPORTING

A review of scheme reports under the Climate Change Governance and Reporting Regulations 2021 published by the Pensions Regulator (TPR) gives examples of where, in TPR's view, reports have omitted information required under the Regulations and statutory guidance.

The legislation underpinning the climate governance and reporting regime is set out in the Pension Schemes Act 2021 and the Climate Change Governance and Reporting Regulations 2021 (the Regulations). There are also three sets of guidance that trustees need to consider, set out in the table below.

Guidance	*Status*	*Content*
Department for Work and Pensions (DWP) statutory guidance on Governance and reporting of climate change risk	The Regulations require trustees of schemes in scope to have regard to the DWP statutory guidance. Trustees can diverge from the statutory guidance but have to explain why they have done so in their annual Task Force on Climate-related Disclosure (TCFD) report.	Sets out how trustees should meet the governance requirements of the Regulations and report in line with the TCFD recommendations.
TPR guidance on Governance and reporting of climate-related risks and opportunities	Indicates how TPR will exercise their regulatory powers.	Explains how TPR decides whether trustees have met the requirements of the Regulations and had regard to the DWP's statutory guidance in doing so.
Guidance: Aligning your pension scheme with the TCFD recommendations, from the Pensions Climate Risk Industry Group (PCRIG)	Non-mandatory. The DWP statutory guidance recommends that trustees refer to the PCRIG guidance.	Advises trustees (of schemes of all types and sizes) on how they can integrate climate issues into their existing governance processes.

TPR has issued a review of a selection of pension schemes' annual TCFD reports, published from mid-2022 by the first tranche of schemes subject to the Regulations. In the review, TPR also updates its "evolving regulatory approach". It had previously said that it would be unlikely to issue penalty notices to trustees of first tranche schemes except where:

- the report had not been published on a publicly available website, accessible free of charge, within seven months of the relevant scheme year end - this attracts a mandatory penalty with a £2,500 minimum and £50,000 maximum for corporate trustees; or
- it was clear that "a genuine effort to comply" with the Regulations had not been made.

However, in future, TPR says it will consider issuing discretionary penalty notices "*where it is clear that trustees have not complied with the Regulations in preparing their report*". Presumably, although TPR does not specify, this applies to both the first and second tranche: governance and disclosure requirements were extended from 1 October 2022 to apply to schemes with £1 billion or more in net assets on the first scheme year end date on or after 1 March 2021. Discretionary penalties are capped at £5,000 for individual trustees and at £50,000 for corporate trustees.

TPR's findings on the reports (which ranged in length from 10 to 85 pages, with an average of 34 pages) outlines some general criticisms and areas for improvement:

- Trustees should explain limitations in their data and any subsequent changes resulting from improved data coverage.
- Some reports lacked sufficient background information. For defined benefit (DB) or hybrid schemes, reports should explain whether there are different sections and whether the trustees considered they have similar characteristics

and so could be grouped for reporting. For defined contribution (DC) or hybrid schemes, reports should say which arrangements the trustees consider to be "popular arrangements". A "popular arrangement" is one in which £100m or more of the scheme's assets are invested, or which accounts for 10% or more of the assets used to provide money purchase benefits, excluding assets which are solely attributable to Additional Voluntary Contributions. DC schemes must carry out strategy, scenario analysis and metrics activities for each popular arrangement offered by the scheme.

- Disclosures of strategy, scenario analysis and metrics activities were not always provided at the appropriate level, as set out in the DWP statutory guidance:
  - For a single section DB scheme, or for a DC scheme with no member choices, disclosures must be at the level of the whole scheme.
  - For a scheme with more than one DB section, they should be at the level of each section, although sections with similar characteristics in relation to assets, liabilities and funding may be grouped.
  - For DC schemes, there should be disclosures for each popular arrangement offered by the scheme.
- Accessibility: some reports were difficult to locate or were not fully accessible to those with different needs.

TPR's review also sets out specific examples of what it regards as required information that was missing, including:

- The roles of those "undertaking scheme governance activities", other than trustees. This refers to those making scheme-wide decisions. If only the trustees make scheme-wide decisions, it should be briefly stated. Where there are other parties (such as a dedicated pensions team within the sponsoring employer), the report should describe their roles and the extent to which any conflicts of interest are being managed.
- The processes the trustees have established to satisfy themselves that those undertaking governance take adequate steps to identify and assess relevant risks and opportunities. According to TPR, this means *"describing how trustees assess the credentials and competence of their employees or advisers"*. This is a strict interpretation of the DWP statutory guidance, which says that trustees should "satisfy themselves" that those undertaking governance activities, advising or assisting have adequate climate-related risk expertise and resources, to the extent necessary for that person's role and adds that: "*trustees may find it helpful to do a skills audit*" on the expertise of trustees and others.
- On strategy and scenario analysis, identifying and assessing the risks and opportunities for each time horizon (short, medium and long-term).
- The potential impact of climate risks on asset values, rather than on the trustees' investment strategy (such as strategic asset allocation and choice of investment mandates). Some DB reports described the impact on liability values, rather than on the funding strategy (such as the long-term funding objective or balance between employer contributions and investment returns).
- TPR expects the majority of DB scheme reports to disclose the trustees' assessment of the impact of climate change on the employer covenant. If the trustees conclude this assessment is not relevant or material, this should be stated with reasons.
- Trustees must describe the processes they have established for identifying, assessing and managing climate risks in relation to the scheme; for example, the process and responsibility for identifying new and emerging risks.

The review also includes what TPR describes as "examples of good practice" which, while not legally required, made the reports more useful or understandable for readers:

- developing a trustee policy on investment beliefs relating to climate change
- checking advisers' climate credentials
- working with investment managers to obtain better data
- allocating more funds to sustainable investments

- using stewardship to manage climate-related risks
- switching to climate-tilted pooled funds.

TPR confirms that the Government will review mandatory climate and stewardship disclosures "later in 2023".

Subsequently, TPR published a blog on ESG and climate reporting, criticising the climate scenario analysis of some scheme reports and calling for more focus on outcomes. The blog also confirms that TPR has started to monitor ESG and stewardship reporting; we discussed this in our Pensions Bulletin March 2023. TPR is checking that trustees of schemes with 100 or more members have published a Statement of Investment Principles (SIP), detailing the policies for how the scheme invests, including consideration of financially material ESG factors including climate risk, together with an Implementation Statement (IS) which shows how the principles in the SIP have been implemented. Trustees must provide a web address to their SIP and IS in scheme returns. TPR warns that enforcement action may be taken if trustees fail to publish SIPs and ISs, although it does not explain its attitude towards trustees who publish their SIP/IS but where the content does not comply with the statutory requirements.

Next steps for employers and trustees: Trustees will need to work through the points raised by TPR with their advisers. Whilst some of TPR's examples of good practice may be helpful, trustees must be cautious when considering non-financial factors, and ensure that legal and investment advice is taken. Trustees will want to note the point about satisfying themselves that those undertaking governance have relevant credentials and competencies.

NEW GUIDANCE ON TRANSFERS FROM THE PENSION SCAMS INDUSTRY GROUP

The Pension Scams Industry Group (PSIG) has updated the main section of its voluntary but influential Code of Good Practice on pension scams. The PSIG Guide is a detailed assessment of trustees' due diligence duties when assessing a pension transfer and highlights areas where the Conditions for Transfers Regulations 2021 conflict with guidance from the Pensions Regulator (TPR) and the risks of using clean lists.

The Pensions Scams Industry Group (PSIG) has published an Interim Practitioner Guide, a version of its Code of Good Practice on combatting pension scams updated to reflect the Conditions for Transfers Regulations 2021, which introduced new restrictions on individual statutory transfers from 30 November 2021. The Government is committed to reviewing the Regulations within 18 months of coming into force (by the end of next month, therefore), so PSIG recommends that the Guide should be used on a standalone basis pending that review.

The PSIG notes that the points of greatest concern in the new restrictions are:

- A "red flag" (the trustees must refuse the transfer) is triggered where the member receives an offer of an incentive to transfer. The offer does not need to be received or shown to have influenced the member's decision.
- An "amber flag" (the member must be referred to guidance) is triggered by the receiving scheme having any overseas investments, even if this is part of an investment fund.

The PSIG is critical of TPR guidance: Dealing with transfer requests. On the amber flag for overseas investments, the TPR guidance states that the concern "*is not whether the investment is in, for example, a global equity fund but whether the investment is in assets or funds where there is a lax, or non-existent, regulatory environment or in jurisdictions which allow opaque corporate structures*". TPR goes on to say that trustees may determine that the transfer can proceed without the need for additional checks, where the receiving scheme is on their "clean list" of low-risk personal pension schemes. The PSIG points out that this approach is risky, given that the Regulations apply to any overseas investments and that almost all pension arrangements are likely to include some overseas investments. Whilst trustees may be able to point to the TPR guidance, any complaint would be determined by the Pensions Ombudsman (TPO), who may apply a strict interpretation of the law rather than approaches based on regulatory guidance or "common sense". The PSIG's view is that, in the context of an amber flag, TPO might conclude that, on the balance of probabilities, given the nature of the receiving scheme, the member would have decided to proceed with the transfer even if they had been referred to MoneyHelper. However, the PSIG warns that TPO might not be able to reach the same conclusion where a transfer was found to include a red flag (such as the presence of an incentive to transfer), because this would mean that there was no statutory right to transfer and the trustees would have potentially breached the Regulations or acted outside their powers.

If a clean list is not used, however, there is a significant risk that a large number of transfers to arrangements which are obviously not pension scams may be slowed down significantly. The Guide notes there have been successful cases brought before TPO by members against transferring trustees for distress and inconvenience and for investment loss as a result of undue delays in relation to transfers out, even where the transfer was made within the statutory time limit.

The Guide comments that all concerns, including whether any red or amber flags have been identified and all written evidence and notes or recording of calls, should be documented.

The PSIG Code has been regarded as the industry benchmark for good practice on due diligence, including by TPO who expects trustees to review transfers processes promptly in line with new guidance on scams. In a 2022 case, TPO upheld a complaint about due diligence failure on a scam transfer and the transferring scheme was ordered to reinstate the member's benefits, amounting to over £200,000 (please see our Pensions Bulletin January 2023). In another recent case, *Mr I*, TPO dismissed a complaint about an administrator's decision not to exercise its discretion to make a transfer to a small self-administered scheme (SSAS) due to pension scam concerns. (The member did not have a statutory right to transfer as part of his fund was in drawdown.) The member complained that the due diligence should have included "a degree of commercial sense", rather than "ticking boxes". TPO considered that the decision not to transfer had been reasonable. The administrator had conducted its due diligence in accordance with regulatory requirements and industry guidelines at the time, including the PSIG Code. There was no obligation to exercise "commercial sense". TPO found that the fact that the member had said he had become aware of the SSAS via a Facebook group was a legitimate cause of concern, particularly because he had not received any regulated financial advice. The administrator had also been entitled to take into account the fact that the SSAS was newly established, the sponsoring employer had recently filed accounts as a dormant company, and the corporate trustee was not registered as a data controller.

Next steps for employers and trustees: PSIG appears to be ambivalent about the use of clean lists at present, in the light of the problems with the Regulations. Pending the Government's review of the Regulations due by the end of next month, trustees will need to continue to consider the risks and factor them into their transfer processes.

LIFETIME ALLOWANCE CHANGES: DEATH BENEFITS UPDATE FROM HMRC

HMRC has responded to concerns about the new rules on taxation of lump sum death benefits which follow the removal of the lifetime allowance (LTA) charge from 6 April 2023, removing the requirement on schemes to operate PAYE.

As a result of the changes announced in the Budget 2023, the following payments, previously subject to a 55% tax charge above the LTA, are now treated as pension income and taxed at the recipient's marginal rate of income tax:

- LTA excess lump sum
- Serious ill-health lump sum
- Defined benefits lump sum death benefit (DBLSDB)
- Uncrystallised funds lump sum death benefit (UFLSDB).

For more detail on the changes, please see our 29 March 2023 Briefing: Changes to pensions tax allowances: an update.

HMRC had previously said, in its LTA guidance newsletter - March 2023, that the process for dealing with DBLSDBs and UFLSDBs would change. Schemes were advised that they would need first to contact the Legal Personal Representative (LPR) of the deceased member to find out the available LTA, to determine whether the LTA had been used up and whether any of the benefit should be subject to income tax at the beneficiary's marginal rate.

HMRC has now confirmed that, in light of concerns raised, it has agreed that schemes may continue to use the current process for taxation of DBLSDBs and UFLSDBs. Under this process, if the member's LPR identifies a chargeable amount after payment of a DBLSDB or UFLSDB, they must report this to HMRC. It is HMRC that then assesses the tax due. Based on information provided by LPRs, HMRC will then raise marginal rate income tax (as opposed to an LTA charge) on the applicable portion of these payments. This process will continue until HMRC develops a longer-term position for the full abolition of the LTA from 6 April 2024.

Next steps for trustees: HMRC has asked schemes to explain, in communications with beneficiaries, that HMRC will contact beneficiaries following the end of the tax year in line with the existing process, but that, instead of the LTA, there will be an income tax charge at the beneficiary's marginal rate.

GUIDANCE FROM THE PENSIONS REGULATOR ON TRUSTEE DIVERSITY

The Pensions Regulator (TPR) has issued guidance for trustees on how to improve equality, diversity and inclusion (EDI).

TPR's Governing bodies: EDI guidance, with separate EDI guidance for employers, includes a number of recommendations for improving EDI, and thereby trustee decision-making. The trustee guidance emphasises throughout the role of the Chair in meeting EDI objectives, at trustee and sub-committee levels; the guidance for employers highlights their responsibility to ensure that EDI is considered by the trustees and to support employees who are trustees. Specific points for consideration include:

- Trustees should have EDI training and develop and maintain an EDI policy.
- EDI objectives and goals should be agreed at the start of the scheme year and should include ways to achieve a diverse and inclusive trustee body - engaging with the employer on employer-nominated selection criteria, for example. Progress on objectives should be a regular agenda item in meetings.
- Performance assessment should include a description of how EDI is embedded into trustee processes. At the annual review, trustees should give their views on how EDI has been covered in meetings.
- On selection of trustees:
  - Employers should consider widening the pool of trustee candidates beyond senior management.
  - Gaps in the trustee body need to be identified and consideration given to appointing deferred as well as active members, selection rather than election of MNTs, and remuneration (which increases the pool of potential candidates).
  - The employer should be involved in developing the Chair succession plan with an EDI focus.
  - The benefits of shadowing and buddying should be discussed.
  - Fixed-term appointments, with a maximum number of terms, can encourage diversity.
  - Reasonable adjustments should be made for trustees with disabilities or health conditions.
- Diversity should also be introduced into the selection or review of advisers and service providers.

Next steps for employers and trustees: The guidance is a helpful checklist on ways of improving trustee diversity. We are expecting more detail on EDI in TPR's Single Code, to be issued shortly.

REGULATORY INITIATIVE ON VALUE FOR MEMBERS ASSESSMENTS

The Pensions Regulator (TPR) has announced that it is launching a new regulatory initiative to check that trustees of defined contribution (DC) schemes with assets under management of less than £100m are complying with requirement to complete a detailed Value for Members (VFM) assessment, under the Regulations and statutory guidance that took effect for scheme years ending after 31 December 2021.

Using data it receives, TPR will contact selected schemes about their VFM assessment (see box below). Where VFM is not demonstrated, the statutory guidance states that the trustees should look to wind up the scheme and consolidate members into a larger scheme, or set out immediate action to be taken to make improvements. TPR's initiative will check that, where required, trustees have improvement plans in place. Where improvements cannot be evidenced, TPR expects trustees to wind up and consolidate.

Value for Members (VFM) assessment

Trustees of schemes with assets below £100 million (based on net assets recorded in the audited accounts) that have been operating for at least three years are required to carry out an annual VFM assessment, considering three factors:

- Costs and charges
- Investment returns (fund performance)
- Governance and administration: promptness and accuracy of financial transactions; quality of record keeping; appropriateness of the default investment strategy; quality of investment governance; level of trustee knowledge, understanding and skills to operate the scheme effectively; quality of communication with members; and effectiveness of management of conflicts of interest.

Costs and charges and investment returns must be assessed relatively, based on comparison with three other pension schemes (with assets of at least £100m).

The outcome and an explanation of the assessment must be reported in the annual Chair's Statement and published on a publicly accessible website. The outcome must also be reported to TPR via the annual scheme return, together with the trustees' intended action if the scheme does not represent good value for members.

Meanwhile, the Department for Work and Pensions has consulted on a new Value for Money framework which would replace the existing VFM assessment. It would require trustees of all occupational schemes that provide DC benefits (excepting some small schemes) to disclose key metrics and service standards and to assess the Value for Money of their scheme. For more details, please see our Pensions Bulletin March 2023. The consultation closed at the end of March; there is no indication of when the new framework is expected to take effect.

Next steps for trustees: Trustees of schemes in scope should check that the VFM assessment is being carried out correctly. The statutory guidance says that, where the assessment reveals that the scheme does not provide value for members, trustees should not wait until they report this in the annual scheme return before taking the necessary corrective action; they should start the winding-up process or improvement plan immediately.

EXTENSION OF DERIVATIVES CLEARING EXEMPTION

The Government has announced that it intends to amend the UK European Market Infrastructure Regulation, in order to extend the exemption for pension funds from the requirement to clear "over-the-counter" (OTC) derivative contracts. The exemption was due to end on 18 June 2023, with the result that, as mentioned in our Pensions Bulletin March 2023, UK pension schemes would then have been required to clear OTC derivatives. The exemption will be extended by two years, to 18 June 2025.

PENSION LEGISLATION AND REGULATION WATCH LIST

No	Topic	Effective date or expected effective date	Further information/action
1	Changes to DC scheme governance and disclosure	From 6 April 2023: removal of performance-based fees from charges cap From 1 October 2023: Inclusion of explanation of illiquid investment policies in default SIPs and disclosure of asset allocation data in Chair's Statement	DC schemes only. Final draft regulations and statutory guidance published January 2023. Consultation on new Value for Money framework and call for evidence on options for automated consolidation of deferred small pots closed 27 March 2023. Consultation on broadening Collective Defined Contribution (CDC) schemes beyond single or connected employer schemes to accommodate multi-employer schemes (including master trusts) closed 27 March 2023.
2	Changes to pensions tax allowances	Finance (No 2) Bill 2023: removal of lifetime allowance charge (replaced with income tax charge on lump sums that could have triggered a charge) and changes to other allowances, from 6 April 2023.	Lifetime allowance will be abolished from 6 April 2024.
3	DB Funding Code of Practice	Part 2 of TPR consultation and draft Code issued 16 December 2022; consultation closed 24 March 2023. Regulations and Code not expected to come into force until April 2024.	DWP regulations issued for consultation July 2022. Once in force, the Code will apply to triennial valuations submitted thereafter. Further consultation expected on covenant guidance.
4	TPR Single Code of Practice	Revised Code expected shortly.	All schemes.
5	New notification requirements for DB schemes in relation to corporate and financing activity and change to the notification process	Response to consultation on draft Notifiable Events (Amendment) Regulations was expected Summer 2022.	TPR will consult on update to Code of Practice 2 (Notifiable Events) and accompanying guidance once DWP have published their finalised regulations and consultation response.

No	Topic	Effective date or expected effective date	Further information/action
6	Pensions dashboards	Compulsory connection deadlines were to apply from 31 August 2023 but are now being revised. Further update expected before Parliamentary recess (20 July 2023).	All registerable UK-based schemes with active and/or deferred members. Regulations in force from 12 December 2022; TPR consultation on compliance and enforcement policy closed 24 February 2023.
7	Retained EU Law Bill	Expiry of EU-derived secondary legislation on 31 December 2023 unless Government legislates to incorporate into UK law or extends sunset to no later than 23 June 2026.	EU law dashboard contains non-comprehensive list of secondary legislation potentially affected.

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