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PENSIONS BULLETIN

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In this month's Pensions Bulletin, we report on developments in the ongoing scheme funding code consultation and on updated guidance from the Pensions Regulator on scheme returns. We analyse the implications of the end of the Brexit transition period for data transfers by pension schemes. We cover the Government's proposals on small pots and changes to the general levy and consider the latest guidance on transfers from gated funds. We conclude with a report of the Government's review of the default fund charge cap.

We have included a new feature at the end of this Bulletin: a watch list of the key pensions legislation and regulation we are expecting over the course of 2021.

In the very latest development, the Pension Schemes Bill has now completed all Parliamentary stages and awaits Royal Assent; please see our client bulletin for details of the major changes to pensions legislation made by the Bill and the next steps and timing for regulations and guidance. Trustees and sponsors need to be aware that the Bill strengthens considerably the Pension Regulator's powers in relation to defined benefit schemes, including introducing punitive and very broad criminal offences and civil penalties. These sanctions can apply to individuals as well as companies and regardless of whether the person being targeted has any connection to or association with the pension scheme or its employer. There will be no formal advance clearance mechanism for confirmation that the new sanctions will not apply to a specific transaction.

INTERIM RESPONSE TO FUNDING CODE CONSULTATION

The Pensions Regulator (TPR) has published a short interim response to its first consultation on the defined benefit funding code of practice, confirming the delay in the consultation process. TPR now anticipates publishing its second consultation in the second half of 2021. We do not expect to see the new regime in place until early 2022; it will then apply to triennial valuations taking place after that.

On 14 January 2021, TPR published an interim response to its first consultation on its proposed new DB funding code. The consultation proposed two alternative routes - Fast Track and Bespoke - for schemes to carry out valuations and to demonstrate compliance with the statutory funding regime.

TPR reports general support for the regulatory approach proposed in the consultation. However, some concerns were raised by respondents, in particular the increased evidential burden and potential loss of flexibility with the Bespoke route and the application of the Fast Track guidelines to open schemes. TPR says that some of these issues stem from misunderstandings, which it will clarify during the second consultation. Subsequently the Government has confirmed, during the final stages of the Pension Schemes Bill, that the code will acknowledge the different position of open and less mature schemes.

TPR comments that the focus on Integrated Risk Management in the key principles means that the principles remain relevant despite COVID-19 and Brexit. However, TPR will take COVID-19 into account in developing Fast Track guidelines for the second consultation.

The Government's consultation on the draft regulations under the Pension Schemes Bill, which underpin the funding code, is currently expected to be in the first part of 2021. TPR therefore anticipates publishing the second consultation, which will include the draft code of practice, in the second half of 2021. We do not expect to see the new regime in place until early 2022.

NEW GUIDANCE ON DB SCHEME RETURNS

TPR confirms that trustees of defined benefit (DB) schemes may be asked to provide a website link to their published Statement of Investment Principles (SIP) in annual scheme returns this year.

TPR has published new information on scheme returns for DB and hybrid schemes, including an example scheme return form. TPR suggests that schemes should allow more time to complete the return, as there have been some changes. The Government has decided that it should create a central directory of SIPs, as a way of checking that trustees are providing the required information on their environmental, social and governance (ESG) and stewardship disclosures. DB schemes may be asked to provide a website link to their published SIP, as well as their assessment of the employer covenant (and where it would sit within TPR's grading system). TPR adds that it expects trustees to review the strength of the employer covenant regularly - at every scheme valuation, as a minimum.

TPR also suggests that schemes might want to download copies of previous scheme returns now, as these may cease to be available due to system updates.

TPR will confirm the final scheme return questions in February 2021, before scheme return notices are issued from the middle of February. The deadline for submission of the return will be 31 March 2021.

BREXIT AND DATA TRANSFERS

For transfers of personal data from the UK, the UK has already deemed EU member states, and other countries that benefit from an EU adequacy decision as at 31 December 2020, to be adequate for the transfer of data. Transfers of personal data from the EU to the UK may continue for an interim period. However, trustees will need to set up alternative transfer mechanisms to safeguard against any interruption to the free flow of data at the end of the interim period. The Information Commissioner's Office (ICO) has confirmed that existing EU Standard Contractual Clauses (SCCs) may continue to be valid for transfers to non-adequate countries. There will be new UK SCCs in due course; this is an area schemes should monitor.

Transfers to the UK: Under the EU-UK Trade and Cooperation Agreement (TCA) of 24 December 2020, transfers of personal data from the EU (and the other EEA states assuming they opt in) to the UK can continue for an interim period of four months, with a possible two-month extension. In a statement on 28 December 2020, the ICO advised that organisations should put in place alternative transfer mechanisms for transfers to the UK, such as EU SCCs, in case no adequacy decision for the UK is forthcoming.

Transfers from the UK: The UK had already deemed the EEA member states, and the countries that benefited from an EU adequacy decision as of 31 December, to be adequate for transfers from the UK, and the TCA does not change this.

For transfers of data to other countries, existing EU SCCs continue to be valid for transfers out of the UK. The ICO has published guidance on SCCs after the end of the Brexit transition period, under what is now known as the "UK GDPR". For new transfers, the current EU SCCs can continue to be used or they can be amended first to reflect Brexit (but nothing else); helpfully, the ICO has created UK versions of the SCCs with suggested amendments. The ICO intends to publish new UK SCCs during 2021.

The guidance reminds us that, after the *Schrems II* decision, organisations should be reviewing whether the SCCs provide sufficient protection for data subjects in the destination country and, if necessary, taking additional measures to mitigate the risks (such as encryption and anonymisation).

DC SMALL POTS: RECOMMENDATIONS FOR CONSOLIDATION

The DWP's Small Pots Working Group has published recommendations to solve the administrative problems (for schemes as well as for the members) caused by the rapid increase of small defined contribution (DC) pension pots for deferred members. The Working Group's conclusion is that consolidation should become the norm in the auto enrolment market and pressure is now on the Government to tackle the problem in the next few months.

The recommendations of the Working Group's report (December 2020) include:

- The Government and regulators should continue to explore opportunities for member-initiated consolidation, particularly for deferred small pots above a certain value. However, this alone is unlikely to change the trend in the growth of DC deferred small pots, so scheme-led consolidation solutions are required.
- The pensions industry, working with Government, should prioritise action to enable automatic and automated large-scale low-cost transfers and consolidation for the auto enrolment market. Member safeguards should provide proportionate protection, but not act as a barrier. For small pots of low value, the development of two consolidation models should be prioritised in 2021: the default consolidator (deferred pots are transferred and consolidated into a single default pot for the individual) and automatic "pot follows member" (the deferred pot is transferred to the individual's active pot).
- The administrative challenges that will be necessary to underpin bulk transfer and consolidation systems need to be addressed. There will be overlap with the development of pensions dashboards.

GOVERNMENT CONSULTATION ON PROPOSED CHANGES TO THE GENERAL LEVY

The DWP has reinstated its proposals to change the structure of the general levy from April 2021. Under the DWP's preferred option, there would be higher rates for DB and (non Master Trust) DC schemes as compared to Master Trust and personal pension schemes. Further, over the next three years, larger levy rate increases are proposed for DB schemes as against other scheme types.

On 16 December 2020, the DWP announced a consultation on proposed changes to the general levy, which funds pensions industry protection bodies such as the Pensions Regulator. The consultation closed on 27 January 2021.

In 2019, the Government decided to increase levy rates by 10% from April 2020, with further increases from April 2021 informed by a wider review of the levy. The decision to increase rates was later revoked because of the pandemic.

The new consultation proposes three options; the DWP prefers Option 1:

- Option 1 – increase rates and introduce separate levy rate scales for DB, DC, Master Trust and personal pension schemes, to reflect the differing levels of supervisory attention for these scheme types. Under this option, there would be moderate increases in the levy for 2021/22 (10% for DB and DC and 5% for Master Trusts and personal pension schemes). Higher increases would then follow in 2022/23 and 2023/24 for DB and DC schemes, with DB schemes having the largest increases.
- Option 2 – as for Option 1 but not separating DB and DC schemes. Both scheme types would have equal, higher, increases in 2022/23 and 2023/24. Master Trusts and personal pension schemes would be treated as in Option 1.
- Option 3 – retain existing levy structure and increase rates (the paper does not specify by how much).

UPDATED GUIDANCE ON TRANSFERS FROM GATED DC FUNDS

TPR has updated the member transfers section of its COVID-19 guidance for DC trustees on scheme management and investment. The guidance confirms that TPR has no power to grant an extension to the statutory time limit for the payment of transfer values from gated funds (funds that have had to close temporarily to investment and *disinvestment during the pandemic because of valuation issues). It suggests that partial transfers could be used as an interim measure, but this poses its own problems.*

TPR has updated the section of its COVID-19 *guidance for pension scheme trustees on DC scheme management and investment* relating to transfer requests from gated funds. TPR made changes to the guidance in 2020 to cover the risks of creating an unintended default arrangement as a result of the temporary closure of funds (see our Pensions Bulletin October 2020).

The latest version of the guidance addresses the problem of member transfer requests where all or part of the investment is gated. While TPR recognises that the payment of transfer values is likely to be problematic, it confirms that the law does not allow it to grant an extension to the six-month statutory time for the payment of a cash equivalent transfer value (CETV) in these circumstances. TPR expects trustees to do everything possible to process the transfer request promptly; it says it "may" fine trustees if they fail to take all reasonable steps to pay a CETV within six months of the application date. The guidance reminds trustees that any significant failure to pay CETVs within the statutory period should be reported, outlining the reasons and the compliance steps being taken.

TPR then suggests that if only part of the investment is in a gated fund, reasonable steps might include exploring with the receiving scheme whether the monies from the gated section could follow once the fund has re-opened and, if so, offering the member a partial transfer as an interim measure. However, the guidance does not discuss the problems presented by partial transfers – they fall outside the scope of the statutory transfer right, with the result that there can be no statutory discharge for trustees. Trustees can make partial transfers only if the schemes rules allow them to do so and the terms of any discharge would be included in the scheme rules.

GOVERNMENT DECISION ON THE DEFAULT FUND CHARGE CAP

As predicted, the DWP has concluded that the charge cap in the default arrangements of DC qualifying schemes used for auto enrolment should not be changed and that it should not include transaction costs. This is in part a recognition of the deterrent effect a reduced cap might have on more ambitious investment strategies. However, there will be a ban on flat fees for default funds less than £100. The Government has not said when this will come into force.

The DWP has published its response to consultation launched in July 2020 on the default fund auto enrolment charge cap. Given market uncertainties and the evidence showing that administration charge levels are not sitting close to the current 0.75% cap limit, the Government will not be changing the level of the charge cap at present. In addition, transaction costs will not be brought within the charge cap, given the difficulty in predicting transaction costs and the limitations on the opportunity for innovation and new types of investment.

However, the Government has concluded that there should be a de minimis pot size for default funds of schemes used for auto enrolment, below which flat fees cannot be charged. Initially the limit will be £100 for each member but the level will be kept under review with a view to increasing it in the future. The response paper reiterates that schemes should consolidate these pots in the long term.

The Government will continue to investigate the possibility of a standardised cost reporting process to help trustees compare costs and charges. The Government will consider legislating on this in due course, if take-up of the voluntary Cost Transparency Initiative disclosure templates is not sufficient.

PENSION LEGISLATION AND REGULATION WATCH LIST

No	Topic	Deadline	Further information/action
1	Statement of Investment Principles (SIP) annual implementation statement	Annual reports which are signed off on or after 1 October 2020	This applies to all pension schemes required to provide a SIP. The requirements for DB schemes are more limited: they do not require a review of the SIP; and limit the provision of details of how the SIP has been followed to voting and engagement only
2	Include annual implementation statement on website	Annual reports which are signed off on or after 1 October 2020	For DC schemes only. (The requirement for DB schemes applies in part only, and later - see 7 below.)
3	Pension Schemes Bill: TPR powers; scheme funding; CDCs; transfer scams; pension dashboards; climate change provisions	Different implementation dates are expected for different parts	Regulations and further consultation expected
4	TPR unified Code of Practice: internal controls section	TPR expected to issue consultation start of 2021	
5	Trustee oversight of fiduciary managers and investment consultants	Compliance statements were due to be provided to CMA by 7 January 2021	New DWP regulations awaited
6	Draft DB Funding Code of Practice	Part 2 of consultation expected in second half of 2021	Further consultation on draft Funding Code and regulations in 2021. The new Code is expected to be in force in 2022
7	Include annual statement on compliance with policy on stewardship and engagement activities, and voting behaviour, on website	I October 2021	DB schemes only

No	Topic	Deadline	Further information/action
8	Climate risk governance and reporting requirements under the Pension Schemes Bill	1 October 2021: governance for the scheme year underway from 1 October 2021 and first annual report published within 7 months of end of scheme year, or 31 December 2022 if earlier	Applies to schemes (DB and DC) with £5 billion or more in net assets on the first scheme year to end on or after 1 June 2020 Regulations under the Pension Schemes Bill expected for consultation January/February 2021
9	Proposals to improve DC scheme governance and disclosure and to encourage consolidation, including changes to the annual Chair's statement and charge cap changes	October 2021	DC schemes only. There will be further consultation on draft regulations and statutory guidance
10	DB superfunds	Interim regulatory regime in place from October 2020	New legislation promised

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