SLAUGHTER AND MAY/

BULLETIN

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PENSIONS BULLETIN

QUICK LINKS

Final guidance on climate risk governance and reporting

Requirement to refer members to guidance before accessing flexible benefits

Confirmation of Pension Protection Fund levy rules 2022/23

Restrictions on flat fee charges in DC schemes

High Court confirms employer’s construction of revaluation rule

Pension legislation and regulation watch list

In this month’s Pensions Bulletin, we cover:

1. Useful clarifications in final Pensions Regulator guidance on climate risk governance and reporting.
2. From 1 June 2022, “Stronger Nudge” guidance duties for trustees when members access or transfer DC benefits.
3. PPF confirms 2022/23 levy rules, with an estimated 80% of schemes paying a lower levy. 31 March 2022 deadline for document submission.
4. Imminent introduction of £100 minimum pot size for DC charges from April 2022.
5. High Court confirms employer’s interpretation of revaluation rule.
6. List of legislation and regulation expected from 2022 to 2023.

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FINAL GUIDANCE ON CLIMATE RISK GOVERNANCE AND REPORTING

The Pensions Regulator (TPR) has now issued the final versions of its guidance and monetary penalties policy. The guidance sets out the factors TPR is likely to take into account in assessing whether trustees have met the (legal) requirements of the Regulations and statutory guidance, as well as TPR's approach to enforcement. There are some important changes of emphasis in relation to trustees' legal duties.

In December 2021, TPR published the final version of its guidance: Governance and reporting of climate-related risks and opportunities, together with a response to its July 2021 consultation. TPR stresses that the guidance should be used alongside the Department for Work and Pensions (DWP) statutory guidance. The TPR guidance is aimed at trustees in the initial group of schemes in scope of the Governance and Reporting Regulations (from 1 October 2021 – see box below), but TPR suggests trustees not subject to the requirements might wish to follow it. TPR says it will contact trustees of schemes that may have moved into scope since the last valuation.

Scheme net assets in billions (Bn)	*Governance requirements apply from 1 October*	*Publish report within 7 months of end of scheme year underway 1 October*
£5Bn+	2021 (unless later audited accounts)	2021 but, for new fourth metric on portfolio alignment only, 2022
£1Bn +	2022 (unless later audited accounts)	2022

Trustees must meet the requirements of the Regulations and must have regard to the DWP's statutory guidance in doing so. To help TPR decide whether trustees have done this, it will be looking for clear evidence that trustees:

- are taking proper account of climate change when making decisions about the scheme, and that advisers are helping to do this;
- have carried out analysis consistent with the Task Force on Climate-related Disclosure (TCFD) recommendations;
- have seriously considered climate change risks and opportunities, in the scheme's particular circumstances; and
- have decided what to do as a result of the analysis and set a target to help achieve it.

TPR has clarified that the guidance does not impose any new requirements on trustees and that the examples do not prescribe a particular approach. However, TPR reiterates that trustees must have regard to the DWP statutory guidance when putting their climate change governance processes in place and when they produce their TCFD reports. There is a slight change of emphasis in the final version - the guidance now acknowledges that trustees' fiduciary duties have not been changed by the Regulations (although the duty to act prudently is relevant) and TPR makes clear the need for climate risks to be considered proportionately and not carried out at the expense of failing to consider other material scheme risks.

The guidance is broadly similar to the July draft (see our Pensions Bulletin July 2021 for more details). Some examples have been extended in response to consultation and TPR says that a step-by-step example covering the whole process will be provided "in the New Year". The consultation response explains other changes to the guidance:

- **Regulatory approach:** in response to concerns that enforcement action could discourage schemes from being open about gaps in information, TPR says that it will recognise where schemes have made a genuine effort to collect as much of the necessary information and data as they can and have recorded the steps they have taken to do so.
- **Sponsor covenant:** TPR is reviewing its covenant guidance and intends to consult on this in 2022, so that it can include more detail on what schemes should do to reflect climate risks when assessing the strength of covenant.
- **Advisers:** the guidance clarifies that trustees are responsible for ensuring that those providing advice and support in relation to scheme governance activities have the necessary knowledge and expertise to carry out

that role. Ultimately, the responsibility for decisions rests with the trustees - they need to be comfortable that they, not their advisers, are making the final decision.

- **Risk management:** the guidance highlights the need for climate-related risks to be integrated with the scheme's wider approach to risk management. There are specific references to stewardship activities in the section on identifying and managing climate related risks.
- **Targets:** TPR has clarified that targets should reinforce risk management, be scheme-specific and not be chosen arbitrarily.
- **Reports:** TPR does not propose to produce an example TCFD report but plans to signpost examples of best practice in future.

TPR has also published an updated Appendix 3 to its monetary penalties policy, setting out its approach to breaches of the Regulations:

- Failure to comply with the requirement to publish a report on a publicly accessible website, available free of charge, will result in a mandatory penalty notice with a penalty of at least £2,500. Where a professional trustee is in place, the minimum penalty will generally be higher. The Appendix explains that the penalty relates to publication of the report, not to its content; in other words, it differs from the mandatory penalty for a failure to prepare a Chair's statement, which applies if a statement does not meet the statutory requirements.
- Other penalties and enforcement options are discretionary. Breaches of governance requirements that will affect member outcomes or make it more difficult for members to understand the report (such as failure to disclose scheme resilience in different temperature scenarios which would make it more difficult for a scheme member to see the implications of different temperatures for their pension savings) are likely to be treated more seriously than a failure to make disclosures. Examples are given of the penalty bands and levels for different types of breach.

Next steps for trustees: The guidance will be an important reference point for trustees of schemes in the first wave (and already subject to the Regulations) and those whose schemes will become subject to the Regulations from October 2022 (see box above). The guidance reveals the extent of the burden on the resources of the trustees and their advisers in gathering and interpreting complex data. Trustees should look out for the further guidance to be issued on sponsor covenant assessments.

REQUIREMENT TO REFER MEMBERS TO GUIDANCE BEFORE ACCESSING FLEXIBLE BENEFITS

Regulations have been finalised for a new requirement for trustees to ensure that a member aged 50 plus has received, or opted out of receiving, guidance before processing their application to transfer or access flexible benefits. A change to the statutory procedure that should be helpful to trustees, given the six-month time limit on making transfers, is that where they are unable to book a guidance appointment for the member despite taking reasonable steps, they are required to do no more than provide details of how to book the appointment.

Flexible benefits and the Stronger Nudge

"Flexible benefits" refers to the greater choice given (from 2015) to members with money purchase or cash balance benefits when accessing them, including taking all of the benefits as a lump sum. The Stronger Nudge requirements will apply to all trustees or managers of occupational pension schemes who receive, on or after 1 June 2022, from a member or survivor aged 50 or above, an application (or communication in relation to an application) to receive, or transfer with the intention of receiving, any rights to flexible benefits under the scheme. The Stronger Nudge will not apply in any of the following cases:

- The request is to transfer for the sole purpose of consolidation.
- The member has already received guidance within the last 12 months.
- Applications for serious ill-health benefits.

The Department for Work and Pensions (DWP) has responded to consultation and finalised regulations amending the Disclosure Regulations to add new requirements requiring trustees to refer members or survivors with **flexible benefits** (see box above) to guidance from Pension Wise when they are proposing to transfer or access their benefits. The new "Stronger Nudge to guidance" requirements will now start on 1 June 2022, not 6 April as originally planned. The Pensions Regulator aims to produce guidance before then.

Some changes have been made to the draft regulations and the amended process will be as follows:

- The requirement to refer for guidance will be triggered on the receipt of an application to transfer flexible benefits or on a communication in relation to an application. This change was made in response to requests for trustees to have the flexibility to refer earlier in the process. It means that, where beneficiaries contact a scheme to discuss their options, the trustees will be able to deliver the Stronger Nudge to guidance at this point and will not need to deliver it again once they receive an application form.
- The Regulations amend the statutory right to transfer, so that trustees will be unable to proceed with an application to transfer any rights to flexible benefits that the member has accrued under the scheme unless the member has received, and notified them of receipt of, the guidance, or opted out, and trustees must explain to the member that they cannot proceed unless this has happened. The DWP explain in their response that although, once the Stronger Nudge has been delivered, trustees must not proceed with the application, or take additional steps to progress it (until the member has confirmed receipt of guidance or opted out), this does not prevent trustees from providing information, such as quotes, to the beneficiary before they deliver the Stronger Nudge.
- Where the request is to transfer rights to flexible benefits, the opt-out notification is no longer required to be in a separate communication to the trustees solely for the purpose of opting out.
- Trustees must offer to book a Pension Wise appointment on the member's behalf, and where the beneficiary declines this offer, or (in a change to the draft) where they are unable to book an appointment suitable for the member despite having taken reasonable steps, they must provide the member with details of how to book a Pension Wise appointment.
- There are exemptions for members who confirm that they have already received Pension Wise guidance within the last 12 months, or that they have received regulated financial advice on the proposed transaction. Those who are applying to access their pension benefits as a serious ill-health lump sum are also exempt.
- The only evidence required is verbal or written confirmation from the member that they either have received guidance or have opted out - trustees do not need evidence that the member has attended the guidance appointment. If no such confirmation is received then the transfer or access request cannot proceed.

Transfers of flexible benefits may result in an overlap of the trustees' duty to refer members for guidance with the requirements for members to receive guidance where there is an "amber flag" for potential pension scams, under the Pension Schemes Act 2021 amendments to the statutory right to transfer that took effect from 30 November 2021. (Please see our Pensions Bulletin November 2021 for details of the new transfer restrictions.) It is for the trustees to explain the purpose of each appointment.

Next steps for trustees and employers: Schemes will need to consider what updates to their processes are needed to address the new requirements in the Disclosure Regulations. This will need to reflect the fact that a transfer or access request for the purpose of accessing flexible benefits cannot proceed until the member has received or opted out of receiving guidance.

CONFIRMATION OF PENSION PROTECTION FUND LEVY RULES 2022/23

The Pension Protection Fund (PPF) will go ahead with its levy rules as consulted on in September 2021, with the introduction, for 2022/23 only, of a 25% cap on schemes facing an increase to their risk-based levy.

The PPF has confirmed the levy determination and rules for 2022/23, as set out in its consultation in September 2021. The PPF estimates that more than 80% of schemes that pay a risk-based levy will have a reduced levy relative to 2021/22. (This is due in part to the introduction earlier in 2021 of a new valuation basis bringing PPF assumptions in line with the bulk annuity market.) For the minority that do not, a new limit will be introduced, for 2022/23 only, which will ensure individual risk-based levies will not increase by more than 25% compared to 2021/22. The PPF has noted the extent to which forced closure of businesses during the pandemic has resulted in downgrades in insolvency risk scores. The PPF reserves the right to disapply the 25% limit (or alter the base value against which it is calculated) where there is a material change in the scheme's circumstances (such as a material increase in liabilities of the scheme) or where the employer has had an insolvency event.

The PPF has updated the amount it expects to collect from the levy to reflect the introduction of the 25% limit, as well as market movements and changes in insolvency risk scores up to the end of October 2021. It now expects to collect £390 million, a reduction of £130 million on the previous levy year.

The PPF's policy statement confirms that the measures introduced in 2021/22, including the Small Schemes Adjustment (a reduction in levies for schemes with less than £20 million of liabilities by applying a factor of 0.5%), the cap on the risk-based levy of 0.25% of liabilities and the COVID-19 payment easement, will remain in place. The policy statement also confirms that it is working with the Pensions Regulator on an integrated set of asset classes for the purposes of the new DB funding regime (see our Pensions Bulletin May 2021). The rules for 2023/24, on which the PPF will consult in Autumn 2022, will incorporate the use of the new asset classes.

The PPF has published a new Appendix to the levy rules and guidance for "Alternative Covenant Schemes" (ACS), bringing together the previously separate rules covering commercial consolidators and "Schemes without a Substantive Sponsor". The PPF's aim is to apply a separate ACS methodology to those schemes where there is no conventional employer covenant and no employment relationship between "employer" and member. The ACS calculation assesses the risk of investment or funding failure, by contrast with the conventional levy, which measures the risk of a scheme claiming on the PPF by assessing the insolvency risk of the sponsoring business. The default position under the ACS methodology is that contingent assets and asset backed contributions are not recognised. The definition of an ACS is deliberately wide and the PPF decides whether a scheme falls within it.

Next steps for employers and trustees: The key dates for 2022/23 are set out in the policy statement. Any scheme wishing to put in place new contingent assets or to recertify existing contingent assets must do so by 31 March 2022. Where trustees wish to certify the value of an asset backed contribution arrangement and any payments made under the arrangement, the same deadline applies. Trustees and employers will want to consider whether any reorganisation of scheme liabilities could result in the scheme falling within the ACS Appendix.

RESTRICTIONS ON FLAT FEE CHARGES IN DC SCHEMES

The Government has finalised regulations for the imminent introduction, for charging years ending after 6 April 2022, of a £100 threshold for charging flat fees in default funds used for auto-enrolment. The Department for Work and Pensions (DWP) has updated its non-statutory guidance on the charge cap. Trustees need to ensure they have sufficient monitoring to know whether the £100 threshold might apply.

The default arrangements within pension schemes used by employers to meet their auto-enrolment duties are subject to a cap on the charges that may be borne by scheme members. The charge cap is 0.75% of funds under management within the default arrangement. Regulations amending the Charges and Governance Regulations 2015 introduce a "de minimis" threshold of £100 below which trustees of schemes used for auto-enrolment cannot impose a flat fee on members' pension savings within a single default arrangement. The Regulations come into force on 6 April 2022, taking effect from a scheme's first charging year ending after that date.

The £100 threshold applies to all members – active and deferred. If a member has multiple pots within the default arrangement, the assessment of whether a flat fee can be charged will be based on the combined value of the pots. Where the value of a member's rights is more than £100 but deducting the full flat fee would reduce the value to less than £100, a partial deduction may be made providing it does not reduce the value to less than £100.

Where a flat fee is deducted more than once per member per valuation period, within the same default fund, this will not be a breach of the Regulations provided that any overcharged flat fee is reimbursed "as soon as is practicable". The DWP has said that this means "before the next valuation date".

Under the charge cap rules, schemes are allowed to charge a combination of a flat fee plus a percentage of funds under management charge. The funds under management charge is not subject to the threshold and can continue to be charged where it will reduce the member's rights to below £100.

The DWP has updated its non-statutory guidance on the charge cap. The guidance says that trustees should ensure sufficient monitoring and controls to provide certainty as to whether the £100 threshold might apply, noting that the decision to charge a flat fee should be determined by reference to the value of the member's rights on the date the fees are calculated, not the charging date.

Next steps for trustees: Trustees' administration procedures now need to be set up to monitor small pots for the purposes of implementing the de minimis rules.

HIGH COURT CONFIRMS EMPLOYER'S CONSTRUCTION OF REVALUATION RULE

The High Court, asked to construe what it described as an "obscure" scheme revaluation rule containing an unexplained reference to pension increases, concentrated on the actual language used.

In *De La Rue plc v De La Rue Pension Trustee Ltd*, the High Court agreed with the interpretation of the sponsoring employer as to the effect of a scheme rule providing for revaluation of deferred benefits in the final salary section. The correct interpretation was that the members affected were entitled to have their benefits revalued whilst in deferment in accordance with the statutory revaluation rather than by reference to the greater of statutory revaluation and the rule providing for pension increases.

Facts: The case concerned Rule 17 of the 2003 Trust Deed and Rules (TDR), a redraft of a 1997 TDR. Rule 17 ("Increases in deferred benefits") stated:

"In relation to a Member of the Final Salary Section only, short service benefits before they come into payment shall be revalued in accordance with Chapter II of Part IV of the Pension Schemes Act 1993.

This rule shall only apply if it would provide a greater increase in deferred benefits than that provided at Rule 21."

Rule 21 dealt with pension increases, providing a cost of living index subject to a 5% cap and, for pensionable service prior to April 2005, a floor of 3%.

The claimants, the principal and participating employers, asked the Court for an order confirming their "Narrower Construction" of Rule 17 - that the revaluation applied the statutory regime in the Pension Schemes Act 1993. This Narrower Construction had been applied in the past. A representative member argued for the "Wider Construction" – that the second paragraph of Rule 17 provided an underpin, so that the benefits had to be revalued by the greater of statutory revaluation and the increase for which Rule 21 provided. If this interpretation had been found to be correct, the scheme's liabilities would have been increased by an estimated £20 million.

Decision: The High Court upheld the Narrower Construction. The Wider Construction required the second paragraph of Rule 17 to be reformulated to read, "*This Rule shall only apply if it would provide a greater increase in deferred benefits than the application to such benefits of the rate of increase specified at Rule 21.*" This was not the language chosen by the drafter of the TDR. It would involve recalculating the amount of an increase to be applied to deferred pensions for which Rule 21 was to be treated as providing, but for which it did not in fact provide. The only increases to which members were entitled at Rule 21 were increases to pensions in payment, not increases in deferred benefits. This made it difficult to argue that the second paragraph of Rule 17 provided for an underpin.

Both constructions were workable. However, the introduction of a separate set of calculations for the purposes of assessing the correct means of increasing deferred benefits was a pointer against the Wider Construction. If the Wider Construction had been intended, there was no obviously good reason for doing it that way.

Next steps for employers and trustees: The case is a reminder that, where there is a potential uncertainty over the interpretation of scheme rules, the law on construction may offer a more flexible alternative to a full rectification process. This does depend though on whether there is sufficient linguistic uncertainty to allow a favourable construction of the wording.

PENSION LEGISLATION AND REGULATION WATCH LIST

No	Topic	Expected effective date	Further information/action
1	Changes to DC scheme governance and disclosure, including the annual Chair's statement and the charge cap	First scheme year ending after 1 October 2021 (changes to Chair's statement); 5 October 2021 (changes to annual scheme return); first scheme year ending after 31 December 2021 (detailed value for money assessments for schemes with assets below £100m) Fee charging years ending after 6 April 2022: £100 de minimis pot size below which flat fees cannot be charged	DC schemes only. DWP to confirm whether look-through mechanism for charge cap compliance will be amended or removed. DWP to review whether fines for non-compliance with Chair's statement requirements should be mandatory DWP proposals on universal charging structure to follow "shortly" Consultation on removal of performance-based fees from charges cap ended 18 January 2022.
2	Restrictions on transfers of a member's cash equivalent transfer value by trustees/managers of occupational or personal pension schemes unless prescribed conditions are met	Transfers where the date of the member's application for a statement of entitlement (DB schemes) or transfer request (DC schemes) occurs on or after 30 November 2021	Final regulations issued November 2021.
3	Trustee oversight of fiduciary managers and investment consultants	Under the Investment Consultancy and Fiduciary Management Market Investigation Order 2019, compliance statements, confirming the extent to which requirements have been met, had to be provided to CMA by 7 January 2022.	Consultation response and new DWP regulations have been delayed until June 2022.
4	DB superfunds	Regulatory regime expected Autumn/Winter 2021/22	Interim regulatory regime in place from October 2020.

No	Topic	Expected effective date	Further information/action
5	New notification requirements for DB schemes in relation to corporate and financing activity and change to the notification process	Draft Notifiable Events (Amendment) Regulations, with expected commencement date April 2022, published for consultation September 2021	Consultation closed 27 October 2021. TPR Code of Practice 2 (Notifiable Events) will be updated.
6	Refer members to guidance before processing application to access or transfer flexible benefits	1 June 2022	For DC schemes only.
7	Draft DB Funding Code of Practice	DWP regulations expected for consultation "Spring 2022. Part 2 of TPR consultation and draft Code expected "late Summer 2022". New Code expected to be operational in December 2022.	Once in force, the Code will apply to triennial valuations submitted thereafter.
8	TPR consolidated Code of Practice	By end of June 2022	TPR consultation issued 17 March 2021 and interim response issued August 2021.
9	Register certain trusts with the Trust Registration Service	Registration by 1 September 2022	Applies to some trusts relating to pension and life assurance benefits where no exemption applies (e.g. bare trusts set up on distribution of a lump sum).

No	Topic	Expected effective date	Further information/action
10	Climate risk governance and reporting requirements	1 October 2022	1 October 2022 for schemes with £1 billion or more in net assets, governance to be in place for the scheme year underway, and the first annual report to be published within seven months of the end of the scheme year. (1 October 2021 deadline applied for all authorised master trusts and collective DC schemes and schemes with £5 billion or more in net assets.)
11	Simpler annual benefit statements	1 October 2022	DC schemes used for auto-enrolment.
12	Changes to the scheme asset information collected through scheme returns	Scheme returns from 2023	DB schemes.

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