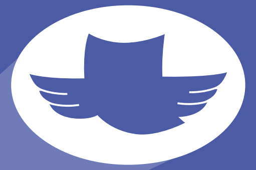
Spotlight on Pensions
PRESENTS
Le Grand View



APRIL 2021

Workload alert: cancel all holidays!

The watershed Pensions Act 1995 introduced a new substantive regulatory system for pension schemes. Schemes and sponsors were then faced with a huge workload to adapt and comply with a deluge of new regulations, policed by a new regulator. Since then, we have grown used to a continuous high-volume flow of further new regulations.

The pace of new requirements has ebbed (sometimes) and flowed (more often) depending upon the number of issues requiring attention and the perceived need for urgency.

On occasion the regulatory landscape has been subjected to "spikes" of major change, challenging schemes' ability to respond within short timescales. 2021 looks to be the start of another spike. Several areas of fundamental change are planned or already underway. When completed, the new regulatory landscape will look quite different from today's. If that were not challenge enough, tight timescales for implementing the changes will test even the best-resourced schemes. The industry is entering one of its most challenging periods since the 1995 Act.

Pension Schemes Act 2021

The Pension Schemes Act 2021 is at the centre of this explosion. The objectives behind the new provisions are well-intentioned and command widespread support. They seek to address issues which genuinely require attention.

However, there are legitimate concerns around implementation. At least some of the new requirements contain flaws which may prove counterproductive. In a number of cases important details are yet to be settled, potentially giving schemes insufficient time to adapt and comply. It would be a pity if the good intentions behind the changes were to be undermined by shortcomings in the practicalities.

New opportunities to become a criminal

One controversial provision of the Act involves the creation of two new criminal offences (in s58). They strengthen the protection of benefits by widening the scope of actions and persons that can be held responsible for inappropriately reducing a scheme's ability to meet its liabilities. The offences have been very widely drawn, to give regulators much greater ability to pursue funds that they may consider to be morally due to schemes.

The offences come into force from autumn 2021. Essentially, they involve:

- Avoidance of employer debt - liability arises if through an act or omission a statutory debt due from an employer to the scheme under s75 Pensions Act 1995 is avoided or compromised or is prevented from becoming due, and the party intended that outcome and did not have a reasonable excuse for their act or inaction.
- Conduct risking accrued scheme benefits - the offence is committed by any person where they engage in an act, or a course of conduct that detrimentally materially affects the likelihood of accrued benefits being received (whether under the scheme or in some other way), and the person knew or ought to have known of the effect of their act or conduct and did not have a reasonable excuse for their actions.

Whilst the former is by its nature likely to apply mainly to those directly involved with the scheme, the latter has the potential for significant and widespread impact. Those potentially within its ambit and the actions (and inactions) covered include remote third parties, involved in an indirect relationship with the scheme or its sponsor, and whose actions are deemed to have contributed to the scheme being unable to discharge its financial obligations in full.

The breadth of these new offences, and the way in which The Pensions Regulator is proposing to operate them is causing concern and the impact on wider business activity may be widely felt over time. Maximum fines of £1m or imprisonment for up to seven years emphasise the seriousness of the offences and the need for anyone potentially affected to develop a protocol to address their risk.

The Pensions Regulator's central role

The Pensions Regulator is, unsurprisingly, front and centre in the new developments. To complement the new regulations, it is redrafting Codes of Practice. A draft of the first stage of a new single code is under consultation. The final objective is to simplify, reorder and consolidate the current 15 codes into one document. The first stage involves 10 codes, with later drafts incorporating the others.

Much of the new code's content reflects the provisions from the current ones. However, there is some new content. One such is for schemes of 100 or more members to produce a written Own Risk Assessment (ORA). Schemes must assess regularly the management of their risks under their existing governance system (the risks themselves already being required to be identified and regularly assessed). Although the Own Risk Assessment will not have to be published, or submitted as a matter of course to the Regulator, it will have to be made available for the Regulator's inspection if requested.

Production of the first ORA will involve a considerable amount of work. Regular reviews will need to be added to the list of items requiring regular attention.

New DB funding proposals

One current code that is not included in the first consolidated draft is Code 3 - Funding Defined Benefits. DB scheme funding is currently the subject of a separate consultation between the Regulator and the industry. Alongside a number of new requirements around funding levels, a key feature of the proposals is for a dual-track actuarial valuation system. This will offer schemes an option of a simplified procedure on a prescribed fast-track valuation basis. The new system is intended to come into force in late 2021, although the pandemic may cause slippage.

Although those schemes adopting the fast-track system will benefit from simplified processes (something that many had lobbied for), changing existing valuation bases to new prescribed ones will likely involve considerable work. Anecdotal evidence suggests that a number of schemes that might have been expected to move to fast-track are unsure that the new bases are appropriate for their scheme, potentially resulting in disappointing levels of take-up.

For those not adopting the fast-track, the process of actuarial valuations will become more onerous, further adding to trustees' workloads and scheme costs.

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The Pensions Dashboard

Another work-generating item is the Pensions Dashboard. This has been in gestation for a number of years, but the intended "go live" date is 2023. The complexities and workload involved in building, from scratch, a system to enable any individual to see all their pension benefits from all sources in one place cannot be overstated.

The key to success lies in the accuracy, availability and security of data. This involves issues of consistency in the description and presentation of data from all sources. Given that historical data in particular is held in multiple formats across a large number of individual schemes (if, indeed, it exists at all) conversion to a single consistent basis will be required.

One particular challenge is how to accurately and consistently predict a member's benefit, whether from a DC fund or in respect of future DB pensionable remuneration, to enable informed planning.

A single system for data retrieval without compromising security will be required. Much of the detail of the requirements has still to be settled, limiting the ability of schemes to devise their internal systems until it is. Once it is, there will be little time for schemes to get their data and systems Dashboard-ready. Meanwhile schemes should concentrate on achieving data accuracy.

ESG, particularly climate-related issues

Improving governance of investments by asset owners beyond the traditional focus on short-term financial return, is a growing movement. The aggregate value of assets owned by pension schemes (around £2trn) makes them a particular focus of attention. Members are also increasingly requiring information and involvement in how their pension funds are invested. This coincides with a wider recognition of a correlation between good governance and strong returns.

The Regulator is commencing a consultation on the "S" (social) and "G" (governance) elements, but measures on environmental issues are already well-established. The number of new duties continues to escalate. The government is particularly keen to demonstrate a "green" UK face to the world when it hosts the prestigious COP26 conference later this year. The agenda to impose a strict climate reporting regime upon pension schemes by then is a top priority.

Trustees, asset managers and insurers will be required to disclose climate-related financial risks and opportunities in line with recommendations by the Task Force on Climate-related Financial Disclosures. Schemes with assets of £5bn or more will be required to do so from October 2021, with schemes of between £1bn and £5bn following a year later. Devising a new reporting regime will involve a substantial amount of work, which will not be made any easier by the absence of an established consistent methodology for measuring and reporting emissions.

Unintended consequences

This is only a brief snapshot of the increased workload awaiting schemes. Once populated with details, the full depth and breadth of the change agenda looks truly daunting. There is sense in bundling up a number of related and overlapping issues and addressing them in one hit, rather than following a piecemeal approach. Governments are often guilty of the latter, so a more consolidated approach is welcome.

The downside is the volume of work that needs to be undertaken concurrently, imposing additional pressure on legislators, regulators and practitioners alike. Unless the timeframe properly reflects this work volume, the resultant pressure risks increased errors and unintended consequences, which can then take a while to correct (if they ever are). The current period presents just such a danger.

Perhaps it is as well that summer holidays may be off the agenda!

For more information on Spotlight on Pensions contact **Pendragon**

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