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February 2021

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Pension Schemes Bill progress report

The *Pension Schemes Bill 2019/21* has cleared its final stage of Parliamentary scrutiny and needs only Royal Assent to make it onto the statute book. Secondary legislation will be required to bring its provisions into force and add details. In the course of business, Government spokespersons gave assurances about the revamped defined benefit (DB) funding regime, and said that none of the new regulatory powers and criminal offences will be retrospective.

Recap

The Bill contains the basis for a new style of benefit provision (collective money purchase); raises the stakes for those inclined toward malfeasance by bringing in serious new criminal and civil sanctions; fixes roles and obligations in respect of the forthcoming pensions dashboards; supports the Regulator's impending shake up of defined benefit scheme funding; shines a spotlight on climate-change risk; and enables trustees to reject fishy transfer applications.

The Bill started life in the House of Lords, which inserted several clauses over the objections of the Government. Their Lordships' changes were concerned with ensuring intergenerational fairness in the new CMP schemes, giving the pensions dashboard being developed by the Money and Pensions Service (MaPS) a one-year head start over any commercial rival, preventing dashboard providers from offering financial-transaction capabilities, and addressing fears that the new DB funding regime would inadvertently hasten the pace of scheme closures. The Government was able to use its majority in the House of Commons to remove the House of Lords' amendments (almost before the ink had dried).

'Ping pong'

On 19 January 2021 the Bill returned to the House of Lords for what is (rather endearingly) known as 'ping pong', or consideration of the amendments made by the other House.[1] At this stage a Bill can be batted back and forth between the two Houses as many times as is necessary for each to accept (however grudgingly) the changes made by the other.

[1] <hansard.parliament.uk/lords/2021-01-19/debates/6D6F0A1E-0B12-4969-8070-54A4DAB00477/PensionSchemesBill(HL)>.

Reassurances

In the event, the Pension Schemes Bill pinged, but did not pong. That is to say, the Government was able to allay their Lordships' concerns sufficiently for them to accept the removal of the clauses that they had inserted; there was no need for another visit to the Commons. Baroness Stedman-Scott, the DWP spokesperson in the Lords said that--

- on CMP schemes, regulations will prevent differences in treatment between age cohorts or membership types;
- no other pension dashboard will receive authorization before the MaPS'; and
- dashboards will be restricted initially to simple find-and-view functions, but with the flexibility to introduce other capabilities giving users more control over their pensions at a later date.

Much of the discussion was about the new funding regime and its effects on open DB schemes. Baroness Stedman-Scott relayed the Government's

> '*clear commitment to ensuring that regulations work in a way that does not prevent appropriate open schemes investing in riskier investments where there are potentially higher returns, provided the risks taken can be supported and that members' benefits and the Pension Protection Fund are effectively protected.*'

'*If they are already doing the right thing,'* she said, '*they should not need to significantly increase contributions as a result of these new measures.*'

Baroness Bowles proposed an alternative amendment that would have explicitly bound the DWP to take such matters into account when regulating. However, Baroness Stedman-Scott persuaded her not to call for a vote on her amendment, by providing assurances that—

- the Government intends to retain the scheme-specific nature of the funding regime;
- detailed provisions will be set out in regulations and the Regulator's Code of Practice, both of which will acknowledge the position of open and less-mature schemes; and
- the Government will engage with interested parties, including a range of schemes, before consulting on draft regulations, and both the DWP and Regulator will publish regulatory impact assessments analysing the effects of different de-risking approaches.

Retrospection

Pensions Minister Guy Opperman has confirmed, in a Written Answer, that the Pensions Regulator will conduct a consultation exercise before publishing guidance on the new criminal offences under the Bill.[2] Other powers need implementing regulations and should be available to the Regulator by autumn. None of the provisions in question will be retrospective, said Opperman: the new criminal sanctions and information-gathering powers will apply where the act (or first of a series of acts) occurs after the powers come into force.

The Bill could become law (an Act) at almost any time now. As we have said, though, secondary legislation will be necessary to bring its provisions into force and settle the technicalities. The Regulator's second consultation on its new DB funding Code, now expected in the second half of 2021, will also be of great interest.[3] In that sense we do not yet have a complete picture of how the changes brought about by the Bill will work or what will have to be done in practice to comply with them. Nevertheless, trustees should understand the potential implications and make allowance for them in their business plans. There will also be a plethora of consultation exercises on regulations and guidance to which they can look forward. Please contact your usual Hymans Robertson consultant if you would like to discuss the issues.

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[2] <questions-statements.parliament.uk/written-questions/detail/2020-12-17/131181>.

[3] Read the separate article in this edition for more information.

TCFD reporting & governance consultation: Government response

The Department for Work and Pensions (DWP) has announced the outcome of last year's consultation on requiring large schemes to disclose their approaches to managing climate-change risks. It also published draft regulations for consultation, and updated the non-statutory guidance drawn up by the Pensions Climate Risk Industry Group (PCRIG).

In August 2020, the UK Government set out its intention to make reporting against the framework set out by the Taskforce on Climate-related Financial Disclosures (TCFD) compulsory for larger pension schemes. The DWP's response to the consultation exercise confirms that it will proceed with its plans, but clarifies some of the original proposals.

Please read our separate Briefing Note for more information.[4]

DC charge cap stays: new minimum fund for flat fees

The Department for Work and Pensions (DWP) has announced the outcome of its review of the statutory charge cap, concluding that it should retain the existing 0.75 per cent per annum limit, for now.[5] It plans, however, to legislate to prevent the application of fixed fees to default pension pots worth less than £100.

The 0.75 per cent per annum cap applies to single-charge structures affecting the default investment arrangements for money purchase schemes that are used for automatic enrolment compliance ('*qualifying schemes*'). The *Pension Charges Survey 2020*, which was released alongside the review, indicates that the average charge across all funds in 'bundled' schemes (those with a single service provider) is 0.48 per cent; for unbundled qualifying schemes the average is 0.49 per cent.[6] The phasing out of legacy, pre-cap schemes meant that all members of qualifying schemes now experienced charges that fell within the cap. In non-qualifying schemes (those not used for AE compliance) the average charge was 0.53 per cent.

Few of those who contributed to the review spoke in favour of having transaction costs brought within the cap. It was felt that their unpredictability could result in inadvertent breaches by otherwise-compliant schemes, and that they might limit opportunities for innovation by using up some of the headroom available within the cap. The Government has accordingly concluded that it should not, currently, incorporate transaction costs into the capped charges.

The review also looked at uptake of the templates produced by the Cost Transparency Initiative (CTI). Their purpose is to establish standards for the reporting of costs and charging information by asset managers to institutional investors, so that the latter can make fully informed value-for-money comparisons. The DWP recognizes that the templates are still in their infancy, and that widespread adoption will take time; however, it is '*committed to ensuring the transparency of costs and changes information for the benefit of pension savers*', and will '*look to legislate in the* [sic] *due course to enable this, if take-up is not sufficient.*'

The Government is concerned about the application of flat fees to small, deferred pension pots that are subject to combination charging structures. It has, therefore, decided to set a £100 *de minimis* pot size for flat fees in qualifying schemes. All of a member's funds held in default arrangements within a scheme will be aggregated for the purposes of the *de minimis* test; the DWP says that it expects to see consolidation of such pots, eventually. The level of the *de minimis* amount will be subject to review.

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[4] : *Climate risk: The Government has responded to its consultation on the Taskforce on Climate-related Financial Disclosures ("TCFD") reporting and governance requirements* <https://www.hymans.co.uk/insights/research-and-publications/>.

[5] *Review of the Default Fund Charge Cap and Standardized Cost Disclosure* <www.gov.uk/government/consultations/review-of-the-default-fund-charge-cap-and-standardised-cost-disclosure>.

[6] *Pension Charges Survey 2020: Charges in Defined Contribution Pension Schemes* <www.gov.uk/government/publications/pension-charges-survey-2020-charges-in-defined-contribution-pension-schemes>.

Funding Code consultation: a holding letter from the Regulator

The Pensions Regulator has published an interim response to first of two consultation exercises about a proposed overhaul of the defined benefit (DB) scheme funding Code of Practice.[7] The interim response is only six pages long, but acknowledges the main concerns that have been raised about the initial consultation proposals. The Regulator promises to consider the submissions and make use of what it learns for the second consultation exercise, which will present a draft of the Code and is likely to arrive '*in the second half of 2021*'.

The first consultation document sketched the outlines of the Regulator's proposals for the revised funding regime. It revealed the Regulator's plans for a dual approach to compliance, with a 'Fast Track' route open to those who prefer the certainty that comes from adopting a set of pre-approved parameters, and a 'Bespoke' option for those willing to pay the price of increased scrutiny in return for greater flexibility.

The interim consultation response says that reactions were generally positive, but lists some of the concerns that were expressed about the practical implications of its twin-track proposals. It says that some of the anxieties arose from misunderstandings, and that it will address them as part of the second consultation exercise. It also points to a recent 'myth-busting' blog post aimed at dispelling such misconceptions.[8]

The timing of the Regulator's second consultation exercise is dependent on Royal Assent to the *Pension Schemes Bill 2019/21* and secondary legislation, on which the Department for Work and Pensions (DWP) is expected to hold its own consultation exercise during the first part of the year. The Regulator indicates that the second consultation paper will set out its thoughts on the process for revision of the Fast Track parameters; its approaches to appraising valuations, engaging with trustees and enforcement; plus an impact assessment with supporting analysis. It says that the impact of COVID-19 will be taken into account.

PPF finalizes 2021/22 levy rules

Further to an announcement made in December 2020, the Pension Protection Fund (PPF) has published its final levy rules for 2021/22.[9] The rules formalize plans to collect an estimated total £520 million in levies, with reductions for smaller schemes. The PPF also published a draft version of guidance on its approach to commercial consolidators ('superfunds').[10]

The PPF has introduced a small-scheme adjustment, which halves levies for schemes with less than £20 million in liabilities and tapers levies for schemes with between £20 million and £50 million of liabilities. The policy statement issued alongside the final rules says that the PPF expects the adjustment to be a long-term feature of the levy.[11] It confirms that the risk-based levy cap will be reduced from 0.5 per cent to 0.25 per cent of a scheme's liabilities, and says that it will be kept under review for future levy years.

In light of the current uncertainty caused by the pandemic, the PPF has departed from its usual policy of establishing rules for the three years ahead. It says that an annual approach will allow for more flexibility, and will be maintained until 2023/24.

It has confirmed that it will 'go live' with the insolvency-risk measurement basis that has been in place since April 2020, using credit ratings and the PPF-specific insolvency risk model operated by Dun & Bradstreet (D&B). It has not changed anything substantial in response to consultation submissions, but will use the feedback to improve services such as web-portal functionality.

The total amount of levies targeted is confirmed at £520 million, as are the retention of the current levy scaling factor of 0.48 and scheme-based multiplier of 0.000021.

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[7] *Defined benefit funding code of practice consultation: Our interim response* (January 2021) <www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/db-funding-code-of-practice-consultation-interim-response.ashx>.

[8] *DB funding code: busting a few myths* (December 2020) <blog.thepensionsregulator.gov.uk/2020/12/08/db-funding-code-busting-a-few-myths>.

[9] <www.ppf.co.uk/levy-payers/levy-2021-22>.

[10] <www.ppf.co.uk/sites/default/files/2021-01/Commercial_consolidator_guidance_0.pdf>.

[11] <www.ppf.co.uk/sites/default/files/2021-01/Policy_statement_Jan_2021_0.pdf>.

Auto-enrolment qualifying earnings and trigger 2021/22

The Department for Work and Pensions (DWP) has announced the outcome of its annual review of the automatic enrolment qualifying earnings band (upon which minimum contributions and benefits are based) and 'earnings trigger' (above which jobholders must be enrolled automatically).[12]

The DWP intends to retain the current £10,000 earnings trigger for the 2021/22 tax year. The lower limit of the qualifying earnings band will also be held at £6,240, whilst the upper limit will be raised from £50,000 to £50,270 (this maintains the band's alignment with the lower and upper earnings bands for paying National Insurance contributions).

The decision to keep the earnings trigger at £10,000 aims to strike the right balance between affordability for employers and savers and ensuring those most able to save are given the opportunity to build up a meaningful level of pension pot. The Government also wants to maintain '*stability at this point in light of the challenging economic circumstances*' as a result of the pandemic. The qualifying earnings band is to be kept aligned with the National Insurance contribution levels to provide '*an important element of consistency for employers, the pensions industry and payroll services'*.

The Government still plans to remove the lower earnings limit for contributions as was proposed as part of the 2017 auto-enrolment review, however it intends to closely consider '*the impact and costs of making changes*' and the '*optimal approach on implementation in the light of the impact of the Covid-19 pandemic and our overall focus on the economic recovery*' before any change is made.

Viral news – January 2021

The Pensions Regulator has updated *its DC scheme management and investment: COVID-19 guidance for trustees* to add a section headed *'Transfer requests where all or part of the investment is gated'*.[13]

A gated investment fund occurs when a fund temporarily closes to contributions and withdrawals (for example a property fund may become 'gated' if the provider is unable to value the property owned by the fund accurately) and they have, unsurprisingly, become more of an issue during the pandemic. The problem with paying a transfer from a gated fund is that the trustees will be unable to disinvest the member's benefits from the fund while it is gated and so will not have them available to transfer.

Since June 2020, the Regulator's guidance has highlighted the issue of creating a 'default arrangement', triggering charge-capping and the requirement for a default-specific statement of investment principles, by moving a member's contributions into an alternative fund if the fund the member selected closed (became 'gated'). In addition, it states that once the gated fund re-opens, the act of re-directing contributions back to the original investment choice could inadvertently make that (original) fund a default arrangement.

Whilst acknowledging the difficulty of paying a transfer from a gated fund, the Regulator does not think that the conditions are met for it to grant an extension to the statutory six-month deadline. Trustees are expected to treat these cases like any other transfer and do everything they can to process them promptly: fines could be imposed if they fail to take such steps as are reasonable to ensure that the payment deadline.

The Regulator suggests that those 'reasonable steps' could involve offering the member a partial transfer if the receiving scheme is willing to accept the part due from the gated fund later. It says that trustees should report materially significant compliance failures, outlining their reasons and the steps taken to meet their obligations.

The circumstances in which the Regulator can grant an extension to the usual six-month transfer-payment deadline are exhaustively detailed in legislation.[14] None clearly applies in this case, so the Regulator's conclusion is not terribly surprising. The legislation does not explicitly cater for the sort of partial transfers advocated by the Regulator either, but it does seem like a potential solution that is worth investigation.

[12] <www.gov.uk/government/publications/automatic-enrolment-review-of-the-earnings-trigger-and-qualifying-earnings-band-for-202122/review-of-the-automatic-enrolment-earnings-trigger-and-qualifying-earnings-band-for-202122-supporting-analysis>.

[13] <www.thepensionsregulator.gov.uk/en/covid-19-coronavirus-what-you-need-to-consider/dc-investment-and-transfer-values-covid-19-guidance-for-trustees>.

[14] Regulation 13 of the *Occupational Pension Schemes (Transfer Values) Regulations 1996* (SI 1996 No. 1847).

Purple Book 2020

The Pension Protection Fund (PPF) has published the Purple Book 2020, which looks at the risks faced by defined benefit (DB) schemes in the year ending March 2020.[15] This edition provides data on 5,318 DB schemes, representing 99.8 per cent of the schemes eligible for PPF compensation. Unsurprisingly, given the current pandemic, the net funding position of DB schemes on a section 179 valuation basis (as used for PPF levy purposes) worsened to a deficit of £90.7 billion, compared to a deficit of £12.7 billion as at 31 March 2019.

Other points of note include:

- the combined deficit of the 63 per cent of schemes which were underfunded schemes was £229 billion as at the end of March 2020 (compared to £160 billion in March 2019);
- only 20.4 per cent of scheme assets are now invested in equities (compared to 24 per cent in 2019); and
- there were £59 billion worth of risk transfer deals (buy-ins, buy-outs and longevity swaps) in the year to June 2020, up from £39 billion worth in the previous year.

FRC SMPI accumulation rate assumptions

The Financial Reporting Council (FRC) has published the results of its annual survey of the accumulation rates used or statutory money purchase illustrations (SMPI).[16] The survey contains the responses received between July and October 2020 from 18 providers (responsible for issuing over 26 million SMPIs).

The rates used for 2020 illustrations were reduced overall compared to those used in 2019. Additionally, in 2020 the FRC asked to what extent the annual statements were impacted by the current pandemic. The responses showed that no changes were made to the rates of accumulation although a limited number of respondents did provide some commentary on investment implications.

[15] <www.ppf.co.uk/sites/default/files/2020-12/35988_PPF_Purple_Book_20_SinglePages_FINAL.pdf>.
[16] <www.frc.org.uk/getattachment/e311e4e7-9a87-485f-ad59-3a8d8f8e5841/AS-TM1-accumulation-rate-survey-FINAL.pdf>.

And Finally…

For the UK's pensions community, the big story on inflation recently has been the Statistics Authority's plan to cloak the CPIH in the RPI's skin, like something from the 1997 movie *Face/Off*; which is a sci-fi action thriller with a premise that is, for those who haven't seen it, ludicrous, utterly preposterous, and… quite good fun if you can overlook its ludicrousness, preposterousness, and general Nick Cage-iness.

The Office for National Statistics, on the other hand, has been geeking out about *'web-scraped clothing'*.[17] This, is turns out, is unrelated to the state of one's habiliment after pushing carelessly through some shrubbery or venturing into a seldom-used attic space and emerging bedecked in arachnoid construction material. Rather, the natstats body is engaged in research into the use of machine learning algorithms for the purposes of classifying clothing data gathered by its army of web-crawling bots.

We were intrigued by references to of a 'gradient-boosted tree machine learning algorithm' (has the tree been planted at the top of a hill?), but the main thing that *AF* took away from it was the sense that we are now *very* close to the point at which Skynet becomes self-aware and decides to eradicate us. Or perhaps humiliate us into submission by manipulating clothing prices so as to have us all wearing Hawaiian shirts with plus fours...

[17] <https://www.ons.gov.uk/economy/inflationandpriceindices/articles/automatedclassificationofwebscrapedclothingdatainconsumerpricestatistics/2020-09-01>

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