TRUSTEE KNOWLEDGE UPDATE

February – April 2023

CMS law·tax·future

LEGISLATION

DC Schemes - investment governance changes

(3 April 2023)

These regulations bring into effect the changes for DC schemes confirmed by the government on 30 January 2023. This includes:

- Trustees of '*relevant schemes*' (i.e. most schemes with DC benefits, other than where they relate only to AVCs) will be required to include information on their illiquid asset policy in the default fund SIP. The policy must include a statement as to whether or not investments include illiquid assets. Where investments do include illiquid assets, the policy must include details of the types of assets and how they are held. Where no illiquid assets are held the policy must include an explanation of why the trustees have chosen not to invest in them. The new requirements will apply on the first occasion that the default SIP is updated after **1 October 2023**, with a requirement that the policy must be included from **1 October 2024** at the latest;
- annual asset allocation disclosures for the default funds of 'relevant schemes'. Trustees will have to calculate the percentage of assets in the default fund allocated to each of the asset classes:

  (a) cash;

  (b) corporate or government bonds;

  (c) shares listed on a recognised stock exchange;

  (d) shares which are not listed on a recognised stock exchange;

  (e) infrastructure;

  (f) property which does not fall within (e);

  (g) instruments creating or acknowledging indebtedness which do not fall within (b); and

  (h) any other assets which do not fall within (a) to (g).
- Trustees must have regard to the statutory guidance when making the asset allocation calculation. This information must be included in the Chair's statement in relation to the first scheme year which ends after **1 October 2023** and published on a publicly available website;
- from **6 April 2023** *'specified performance-based fees'* are excluded from charges subject to the charge cap. Trustees must take into account the statutory guidance when deciding whether a fee falls within the prescribed definition. The trustees must include information on the amount of any performance-based fees in the Chair's statement and publish it on a publicly available website. Where trustees have already adopted performance fee smoothing for the purposes of the charge cap the new provisions do not apply until the first charges year which ends after the earlier of the date which is 5 years after the end of the first charges year in which the trustees first chose to apply performance-fee smoothing and **5 April 2028**.

GOVERNMENT AND PARLIAMENT

Reset of Pensions Dashboards timetable

(2 March 2023)

Pensions Minister, Laura Trott MP, has confirmed DWP plans to "reset" the current pensions dashboards timetable. The first connection deadline is currently **31 August 2023** in accordance with the Pensions Dashboards Regulations 2022. However, the DWP now considers that additional time is required and will legislate at the earliest opportunity to amend the timing. Further information is expected before the Parliamentary recess in July.

Comment

Despite this pause in the project, the government is still committed to pensions dashboards. TPR has said that trustees should continue to engage with their administrators in order to prepare. Whilst most schemes will rely on their administrator to put in place a dashboard connection, the trustees are responsible for compliance and so need to make sure the arrangements set up by their administrator are appropriate.

Spring Budget 2023 - key pensions announcements

(15 March 2023)

The Chancellor of the Exchequer has announced pensions tax changes, including the future abolition of the lifetime allowance (LTA). Key points to note, as set out in an HMRC policy paper, are that from 6 April 2023:

- The standard Annual Allowance will be increased to £60,000;
- The Money Purchase Annual Allowance and minimum tapered Annual Allowance will be increased from £4,000 to £10,000;
- The adjusted income level for tapered Annual Allowance is increased from £240,000 to £260,000;
- The lifetime allowance charge is abolished;
- Pension Commencement Lump Sums (PCLSs) will have a monetary limit of £268,275 (25% of the current LTA), except where existing protections apply;
- Specified lump sums currently subject to a 55% tax charge above the LTA, will be taxed at the recipient's marginal rate.

These changes are set out in the Finance Bill. The complete removal of the LTA from pensions tax legislation will be included in a 'future' Finance Bill.

HMRC newsletter 148 and a Lifetime Allowance guidance newsletter provide further information including:

- the LTA charge will be removed from 6 April 2023 and the LTA will be fully abolished from the 2024 to 2025 tax year;
- the LTA framework remains in place from 6 April 2023. Scheme administrators will need to continue to operate LTA checks when paying benefits and to issue Benefit Crystallisation Event statements;
- members who hold a valid enhanced protection or any valid fixed protections, where this protection was applied for before 15 March 2023, from 6 April 2023 will be able to accrue new pension benefits, join new arrangements or transfer without losing this protection. They will also keep their entitlement to a higher PCLS.

HMRC subsequently confirmed that existing processes can continue to be used for the taxation of certain death benefit lump sums.

Comment

This is the first time for many years that the AA has received a significant increase - whilst the effective dismantling of the LTA represents a definitive break from the pensions tax regime in place since 2006.

Schemes should review and update their communication materials. Employers may also wish to revisit any arrangements they have in place, particularly for high earners, to mitigate the impact of the current restrictions. Employers that currently exclude members with LTA protections from being automatically enrolled (or re-enrolled) could now also reconsider their approach.

Green Finance Strategy

(30 March 2023)

The government has published its new Green Finance Strategy setting out plans to strengthen the UK's position in the global green finance market, while driving private investment to deliver its energy security, net zero and environmental objectives. Key points of relevance for pension schemes include:

- the government will (in Q4 2023) work with the FCA, FRC and TPR to review the regulatory framework for effective stewardship, including the operation of the UK Stewardship Code;
- the DWP will, in late 2023, examine the extent their Stewardship Guidance is being followed and engage with stakeholders on how to clarify fiduciary duty;
- the government will work closely with financial regulators, including TPR, to ensure that the UK's regulatory framework supports the growth of green finance;
- a new Long-term Investment for Technology and Science (LIFTS) initiative tailored to the needs of DC pension schemes and further pooling of LGPS assets, as announced in the Spring Budget.

State Pension age Review 2023

(30 March 2023)

The government has published the results of the Review of State Pension age (SPa). Having considered a report from the Government Actuary's Department and an independent report by Baroness Neville-Rolfe, the Secretary of State considers that the increase to SPa from 66 to 67 in 2026-2028 as currently planned is appropriate and will therefore take place.

Under current legislation SPa is due to increase from 67 to 68 in 2037-39. The independent report recommended that the timetable should be pushed back to 2041-43. However, the government has decided that it is not appropriate to make a decision on this at the moment due to the current level of uncertainty in relation to the data on life expectancy, labour markets and public finances. A further review of the increase to age 68 is now planned within two years of the next Parliament.

THE PENSIONS REGULATOR

Increased focus on climate and ESG non-compliance

(22 February 2023)

TPR has launched a new campaign to make sure trustees are meeting their ESG and climate change reporting duties. The campaign includes a regulatory initiative in the spring to check whether trustees publishing ESG data. Emails are being sent to schemes making clear that TPR is analysing scheme return data to monitor compliance. A review of a cross-section of SIP and implementation statements will follow in the summer.

Engagement with TPR when sponsor is in difficulty

(8 March 2023)

In this blog TPR reminds trustees that in its view there are three key things to consider when the sponsor is in difficulty:

- the importance of having a comprehensive financial information-sharing package that includes detailed forward-looking forecasts, which is assessed regularly by appropriately qualified independent covenant advisers, with costs borne by the sponsoring employer;
- the need to involve TPR at an early stage when it becomes clear that trading for a sponsoring employer is challenged, when the viability of a company is uncertain or if there are issues or defaults with other key financial creditors; and
- it is important to ensure trustees have the right skills to deal with a distressed situation and have access to expert advisers.

Guidance on employer-related investments

(14 March 2023)

TPR has issued new guidance reminding trustees that a breach of the restrictions relating to employer-related investments (ERI) can lead to fines of up to £50,000, or imprisonment, or both. The guidance confirms that, aside from certain exceptions, not more than 5% of the market value of scheme assets may at any time be invested in ERI (and employer-related loans or guarantees are absolutely prohibited).

Pensions dashboards: updated guidance

(15 March 2023)

TPR has updated its pensions dashboards guidance to incorporate the Pensions Dashboards Regulations 2022 and Money and Pensions Service standards. It also refers to the government's 'reset' of the timetable commenting it 'strongly advises' trustees to make the most of the time available to prepare.

Equality, diversity and inclusion guidance

(28 March 2023)

TPR has published a suite of guidance on equality, diversity and inclusion (EDI). This includes separate guidance for governing bodies and employers as well as template documents for recruiting trustees. The DC guide on communicating and reporting has been updated to include a new section on inclusive communications.

Comment:

TPR hopes that these guides will be used by trustees and sponsoring employers to improve the EDI of their scheme's board. Particular focus is given to the role of the chair of trustees in making boards more diverse and inclusive – in some cases this may mean a review of MNT arrangements. TPR suggests that schemes should have an EDI policy in place and ensure that scheme communications consider the diverse range of backgrounds, needs and vulnerabilities of their members.

Using leveraged liability-driven investment

(24 April 2023)

Further to its initial statement last November and the Bank of England's statement in March, TPR has issued more detailed guidance for trustees on managing risk when using leveraged liability driven investments:

- trustees should invest only in leveraged LDI arrangements with an appropriately sized buffer: an operational buffer specific to the LDI arrangement to manage day-to-day changes, as well as the 250 basis points minimum to provide resilience in times of market volatility;
- the guidance provides additional information on the place of LDI in the scheme investment strategy; the use and operation of the collateral buffer; resilience testing; governance and controls; and LDI monitoring. It also cross-refers to existing TPR guidance on investment monitoring and scheme advisers;
- trustees should understand what monitoring their advisers or LDI managers perform routinely - and ensure they receive sufficient information from them to be able to understand and react to risks;
- TPR recommends that LDI managers are asked what steps they have taken to meet FCA good practice (see the FCA's guidance for

LDI managers), and that pooled funds are asked to confirm how they meet guidance from National Competent Authorities (NCAs).

Annual Funding Statement 2023

(27 April 2023)

TPR's Annual Funding Statement (AFS) is addressed particularly to trustees and sponsoring employers of DB schemes with valuation dates between 22 September 2022 and 21 September 2023 (known as Tranche 18, or T18). It is also relevant to schemes undergoing significant changes that require a review of their funding and risk strategies.

Key messages in the AFS include:

- Most schemes have improved funding levels through a combination of investment out-performance and a significant rise in gilt yields. Many are expected to have exceeded buyout funding levels. Trustees will need to consider if their long-term targets remain appropriate, whether buy-out is viable, or to examine other endgame options.
- If funding levels have improved significantly, trustees should consider whether continuing with the existing strategy and level of risk is in the best financial interests of members. If not, they should consider applying some of the funding gains towards a less risky funding and investment strategy.
- Schemes where funding levels have fallen will need to reset funding and investment strategies to reach their long-term targets and should review their operational governance processes to ensure future resilience.
- The level of risk that trustees decide to build into their scheme's funding and investment strategies should be supported by the support available from the employer covenant. Trustees should consider obtaining independent specialist advice to help them, particularly where the covenant is complex or deteriorating, or if it has been materially affected by recent market events.

TPR confirms that it expects the new DB Funding Code to come into force in April 2024 (at the same time as the new regulations) and that it will issue new guidance on assessing and monitoring covenant later this year.

MISCELLANEOUS

Data readiness for buy-in and buyout

(27 February 2023)

PASA has published guidance aimed at supporting trustees and administrators in preparing for an insurer transaction and covers:

- the consequences of holding incomplete and poor-quality data (including the assumptions insurers may make);
- the key data-items which should be held for all members;
- the actions trustees can take in advance of buy-in/out to demonstrate good governance (including evidence of data testing and rectification); and
- quick wins (these include complete and accurate common data and mortality screening).

Pension Scams Industry Group (PSIG) Interim Practitioner Guide

(20 March 2023)

PSIG has released a detailed new industry-wide Interim Practitioner Guide for schemes, providers and administrators to use on pension transfers. This sets out the due diligence steps for assessing a pension transfer in light of the Conditions for Transfer Regulations which came into force in November 2021, with a particular emphasis on "clean lists", how to maintain them, and the risks involved. It also contains considerations for trustees in applying the rules, including red and amber transfer flags and the possibility of using discretionary transfers where a member has no statutory right under the Regulations.

The Guide includes lists of minimum information required for all transfer requests, issues to be discussed between the trustees and administrator, examples of high risk and unregulated investments and what members should be told when being referred to MoneyHelper following an amber flag.

PSIG says that the existing Code of Practice will not be overhauled until DWP has completed its proposed statutory review of the Regulations.

The latest edition of PASA's DC Governance Watch also focusses on the transfer conditions regulations. It suggests that trustees should consider setting out policies concerning how they will assess whether amber flags have been triggered. Governance procedures should also clearly state what transfers can be dealt with by the administrators, what cases need to be raised with other advisers and when matters need to be raised with trustees. PASA also suggests that there is industry support for the creation of a central scheme safe list which would remove some of the duplication and cost from the transfer process.

Comment:

The Guide took effect immediately and is to be read alongside the existing Code and other supporting documents. Trustees and administrators need to ensure that their transfer rules and processes reflect this updated guidance.