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NEWSLETTER

SEPTEMBER 2023

PENSIONS BULLETIN

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In this month's Pensions Bulletin, we cover:

1. A blog from the Pensions Regulator (TPR) highlighting the need for trustees making climate risk reports to consider in each scheme year whether they should undertake new scenario analysis.
2. TPR updated guidance for defined contribution schemes to reflect new disclosure requirements on default illiquid asset investment policy and asset allocation.
3. The Pension Protection Fund (PPF) has launched its annual levy consultation.
4. Legislation allowing the Government to extend the coverage of auto-enrolment.
5. Proposed amendments to PPF compensation levels to reflect existing case law.
6. Draft regulations to reflect case law on same sex partner benefits and notional comparators in relation to GMP equalisation.
7. Recommendations of the Taskforce on Nature-related Financial Disclosures, designed to provide a framework to allow companies and investment managers to assess and monitor nature-related risks.

We include our regular watch list of current and future developments.

THE PENSIONS REGULATOR'S BLOG ON CLIMATE SCENARIO ANALYSIS

Under the Climate Change Governance and Reporting Regulations 2021, trustees of schemes in scope must "as far as they are able" carry out scenario analysis in the first year in which the governance requirements apply and then at least every three years thereafter. In the intervening years, trustees must review whether they should undertake new analysis, taking account of the Department for Work and Pensions (DWP) statutory guidance on governance and reporting of climate change risk and either carry out new scenario analysis or explain in their Task Force on Climate-related Financial Disclosures (TCFD) report why they have decided not to do so.

The Pensions Regulator (TPR) has published a blog: *How trustees can help make climate scenario analysis 'decision-useful'*, referring to recent concerns about the integrity of some climate scenarios used by trustees for their TCFD report. TPR has raised this issue in blogs earlier this year and in its review of the first tranche of trustees' reports, which highlighted areas where the reports failed to meet the detailed requirements of the Regulations and DWP statutory guidance (please see our *Pensions Bulletin April 2023*). The latest blog says that the models used for climate change scenario analysis have tended to downplay the full scope of climate risks. TPR also specifies what it expects from trustees:

- They do not need to be experts but should have an appropriate level of knowledge and understanding of climate issues.
- They should have regular training and ask for additional training if they do not feel comfortable making decisions based on the information they have received.
- There should be a regular review of the climate-related capabilities of service providers and consideration of the need for additional advisers or specialist input.
- They should be able to understand the narratives underlying their climate scenarios, the limitations of those scenarios and the assumptions made. They should then rationalise the output from the scenarios for their scheme.
- Together with advisers, they should consider whether to use stress testing and tail risk analysis to complement the application of the climate scenario analysis to their decision making on investment strategy.

TPR confirms that, in the years where in-scope trustees are not formally required to undertake scenario analysis, they are expected to review their most recent analysis and consider undertaking more. The DWP statutory guidance mentions several circumstances that are likely to lead trustees to decide that fresh scenario analysis is necessary: a material increase in the availability of data, a significant change to the investment or funding strategy or other material change in the scheme's position. It also sets out two further circumstances that might lead trustees to consider undertaking new analysis: the availability of new or improved scenarios or modelling capabilities or events that might reasonably be thought to impact key assumptions underlying scenarios, or a change in industry practice or trends on scenario analysis. TPR emphasises the requirement under the Regulations that, where trustees do not undertake new analysis, they must explain the reasons for their decision in their TCFD report.

TPR says that where trustees have already completed their scenario analysis, using climate scenarios which have been challenged recently, but not finalised their TCFD report, it would be useful for members if trustees could provide additional commentary in the report on the analysis and how the trustees expect it to develop. Where they have finalised their report, they can record additional comments in their board minutes and make them available to members. In both cases, trustees should consider if additional analysis or action is needed.

Next steps for employers and trustees: Despite deficiencies in current climate change models, it is clear from this and earlier messages that TPR regards the Regulations as having embedded climate change issues in trustee governance and risk management. Review of the Regulations is expected later this year, when the Government will consider whether the requirements should be extended to smaller schemes; there is likely to be pressure on it to do so. It is clear that TPR already considers climate change to be an issue that all schemes should have regard to, irrespective of size.

THE PENSIONS REGULATOR'S UPDATED DC GUIDANCE ON INVESTMENT DISCLOSURE

The Pensions Regulator (TPR) has updated three sets of guidance for defined contribution (DC) schemes to reflect recent extensions of trustee disclosure requirements to cover default illiquid asset investment policy and asset allocation, which take effect from October 2023, as well as performance-based fees.

The Occupational Pension Schemes (Administration, Investment, Charges and Governance) and Pensions Dashboards (Amendment) Regulations 2023 introduced three changes for DC trustees to be aware of:

1. A requirement to disclose their policies on illiquid investments in any default Statement of Investment Principles produced after 1 October 2023, or by 1 October 2024 at the latest. (Illiquid assets are those that cannot easily or quickly be sold or exchanged for cash and include any such assets held in a collective investment scheme.)
2. A requirement to disclose and explain the percentage of assets in default funds allocated to different asset classes in the annual Chair's statement covering the first scheme year ending after 1 October 2023.
3. The ability, from 6 April 2023, to exclude specified performance-based fees from the list of charges falling within the regulatory charge cap limit of 0.75% per annum. Schemes must disclose in their Chair's statement any performance-based fees incurred in relation to each of their default arrangements, calculated as a percentage of the average value of the assets held in those defaults.

There is Department for Work and Pensions statutory guidance on 2 and 3 above, to which trustees must have regard.

TPR has updated three sets of guidance to reflect the changes:

- Code of Practice 13: Governance and administration of DC schemes.
- DC investment governance.
- Communicating and reporting: DC schemes.

Next steps for employers and trustees: TPR regards the new requirements on asset allocation reporting as designed to ensure trustees consider all the investment opportunities available and it has said that it will be monitoring the impact of the changes on trustee investment policy.

PENSION PROTECTION FUND PROPOSALS FOR 2024/25 LEVY

On 11 September 2023, the Pension Protection Fund (PPF) announced consultation on the levy rules for 2024/25. The consultation closes on 30 October 2023 and the PPF expects to publish the final levy rules in December 2023.

The key proposals are:

- The 2024/25 levy estimate will be set at £100 million, a reduction of £100 million on 2023/24. Minimal changes to methodology are proposed, focused solely on those needed to achieve the £100 million estimate.
- The levy scaling factor will be set at 0.40 (2023/24 comparator 0.37) and the scheme-based levy multiplier is to change to 0.000015 (2023/24 comparator 0.000019). These small adjustments are to keep the scheme-based levy within the legislative maximum of 20 per cent of the total levy.
- The risk-based levy cap is to remain at 0.25 per cent of scheme liabilities.

The PPF expects the vast majority of schemes to see a decline in their total levy under this proposal and it is estimated that around 60% of schemes will pay no risk-based levy at all.

Other proposals in the consultation include:

- Clarification that no legal opinion is required for the asset-backed contributions (ABC) Certificate if the ABC has terminated and there are no future payments.
- The option for the Covid easement will no longer be offered. Where schemes/employers need more time, applications can be made under the existing payment plan process.

The consultation also looks at levy options for future years. Legislation limits the levy and the extent to which it can be increased. This constrains how low the PPF can allow the levy to fall without damaging the ability to respond to a funding challenge. The PPF therefore plans to ensure the levy remains at or above £100 million in future years. However, because the number of schemes paying a risk-based levy is expected to continue to decline, more substantial changes are likely to be necessary to maintain a levy of £100 million in future years and to avoid the burden of it falling on an increasingly smaller number of poorly funded schemes. The PPF is seeking views on how to distribute the levy at the £100 million level among schemes. The outcome of the consultation will be reflected in the PPF's consultation this time next year but larger well funded schemes should note that it could result in them paying higher levies in the future.

Key dates for employers and trustees:

- Submission dates:
    - Scheme returns and electronic contingent asset certificates to TPR by 31 March 2024.
    - ABC certificates and special category applications to the PPF by 31 March 2024.
    - Contingent asset documents to the PPF by 5pm on 2 April 2024.
    - Deficit Reduction Contributions certificates to TPR by 5pm on 30 April 2024.
- Mean scores will be published in July 2024; invoicing starts Autumn 2024.

LEGISLATION TO ALLOW EXTENSION OF AUTO-ENROLMENT

Employers have a duty to auto-enrol workers who are aged 22 or over and have earnings of more than £10,000 into a pension scheme and to pay contributions on their behalf. Broadly speaking, minimum contributions and benefits are calculated by reference to "qualifying earnings" which are currently earnings between £6,240 and £50,270. Where an individual has "qualifying earnings" but is under age 22, they must be given a right to opt-in to an appropriate auto-enrolment scheme. The Pensions (Extension of Automatic Enrolment) Act 2023 will allow regulations to change the existing age condition and the definition of qualifying earnings.

The Act reflects a commitment the Government made in its 2017 Automatic Enrolment Review to reduce the age from which employers need to auto-enrol employees from 22 to 18 and to ensure that pension contributions are calculated *"from the first pound earned"* rather than from the lower qualifying earnings threshold. The Act does not specifically make these changes but introduces a regulation-making power allowing the Secretary of State to reduce the qualifying earnings threshold and the age from which the auto-enrolment duty applies.

The Act does not provide for the £10,000 earnings threshold which employees must meet to qualify for auto-enrolment to be amended. In the Automatic Enrolment Review, the Government confirmed that did not intend to make this change but said that if employees with earnings below this threshold exercised their right to opt-in to an auto-enrolment scheme, they would also benefit from contributions on all of their earnings, adding that there would be an incentive for those in multiple jobs to opt-in "*as they would benefit from an employer contribution for every pound they earn in every job*" up to the upper threshold of qualifying earnings. The extent to which more employees opt-in as a result of these changes will depend on the extent to which they are publicised, either by their employer, the Government or the Pensions Regulator.

Next steps for employers and trustees: The Act is an enabling provision only and regulations are required both to bring it into force and to make any changes to the existing auto-enrolment requirements. However, during the passage of the Bill through Parliament the Government suggested it would be consulting on draft regulations this year. Employers need to watch out for them to ensure that their auto-enrolment processes are updated to capture all relevant employees and consider the likely cost of these changes. It will also be interesting to see whether consultation on draft regulations looks at further expansion to the auto-enrolment regime as there has been significant industry comment to the effect that existing contribution levels are not sufficient to guarantee an adequate income in retirement.

PROPOSED AMENDMENTS TO PENSION PROTECTION FUND COMPENSATION TO REFLECT EXISTING CASE LAW

Amendments are being proposed to the levels of Pension Protection Fund (PPF) compensation set out in legislation to reflect recent case law. The changes reflect what the PPF is already doing in practice and are needed because of changes to the status of European case law under the Retained EU Law Act 2023 from 31 December 2023.

In 2018, the Court of Justice of the EU held in *Hampshire v PPF* that European law required members to receive at least 50% of their accrued pension benefits in the event of employer insolvency. The vast majority of PPF members were receiving compensation in excess of this limit but the PPF responded by increasing the amount payable to those who were not. A subsequent Court of Appeal decision in *Hughes v PPF* confirmed that the 50% limit could be tested on a one off basis and did not have to be revisited year on year. It also confirmed that the cap on PPF compensation for members under normal pension age at the beginning of a PPF assessment period (£41,461.07 in 2022) was unlawful on the grounds of age discrimination. The PPF subsequently ceased to apply this cap and is in the process of paying arrears where required. A further 90% cap on benefits for such members continues to apply.

These changes were based on European law principles and have not been incorporated into the legislation setting out PPF compensation levels. Under the Retained EU Law Act, with effect from 31 December 2023, UK courts will not be bound by European law principles or cases. This means that to retain the basis on which the PPF has been calculating compensation in recent years, amendments to legislation are required. *The Pensions Act 2004 (Amendment) (Pension Protection Fund Compensation) Regulations 2023* do that (subject to Parliamentary approval), introducing a 50% minimum compensation level, allowing it to be tested once and removing the compensation cap.

Next steps for employers and trustees: As the draft regulations reflect changes that the PPF has already been implementing and are anticipated to affect only small numbers of members, they should not result in any changes to the PPF levy or require any action from trustees or administrators.

PROPOSED AMENDMENTS TO EQUALITY LEGISLATION TO REFLECT EXISTING CASE LAW

The Pensions Act 2004 and the Equality Act 2010 (Amendment) (Equal Treatment by Occupational Pension Schemes) Regulations 2023 propose changes to UK law as a result of the change in status of EU law principles and cases under the Retained EU Law Act 2023 from 31 December 2023. They address the historic rights of same sex partners and the need for a comparator in relation to GMP equalisation and are intended to maintain the existing position.

Provisions protecting same sex civil partners and spouses: UK law has prohibited discrimination on grounds of sexual orientation since December 2003. However, same sex partnerships had no legal status until the Civil Partnership Act came into force on 5 December 2005. The Equality Act 2010 currently requires same sex civil partners and spouses to be treated in the same way as partners of the opposite sex, but only with effect from 5 December 2005. In relation to pensions, this means that survivors' benefits for same sex partners are only required in relation to service from that date.

In 2017, the Supreme Court held in *Walker v Innospec* that the 5 December 2005 cut-off breached EU equality requirements in relation to survivors' pensions. In light of this decision, the vast majority of schemes have adjusted survivor benefits payable to same sex partners to ignore the 5 December 2005 cut-off.

As *Walker v Innospec* is based in EU law principles, the Retained EU Law Act 2023 means that UK courts will need to ignore it from 31 December 2023. To maintain the current position, these draft regulations will amend the 5 December 2005 cut-off in the Equality Act so that it no longer applies to survivors' benefits under an occupational pension scheme.

Need for a comparator in relation to GMP equalisation: Generally, to establish discrimination under the Equality Act an individual needs to be able to show that there is someone who they are being treated less favourably than and who does not share their protected characteristic. This person is referred to as a "comparator". The Government has long held the view that it is not necessary to identify an actual comparator in relation to GMP equalisation because the European Court of Justice decided in *Allonby* that a notional or statistical comparator could be used where sex discrimination was caused by legislation. This view is reflected in its 2019 Guidance on GMP equalisation.

As the Retained EU Law Act will mean that the relevant case law will no longer apply and the Equality Act does require an actual opposite sex comparator before an overriding sex equality rule can operate to remove any discrimination, the draft regulations provide that a notional comparator will be sufficient in relation to GMP equalisation.

Next steps for employers and trustees: As both sets of proposals maintain the status quo and reflect what schemes have been doing in practice, they are to be welcomed and should not increase costs or administrative requirements for either employers or schemes.

FINAL RECOMMENDATIONS OF TASKFORCE ON NATURE-RELATED FINANCIAL DISCLOSURES

Nature-related risks relate to risks to eco-systems and biodiversity. They are distinct from climate change risks but closely aligned to them. These recommendations are intended to provide a framework to allow companies and investment managers to assess and monitor nature-related risks.

The Taskforce on Nature-related Financial Disclosures (TNFD) consists of 40 senior executives from companies and financial institutions representing globally over $20 trillion in assets under management. Its recommendations provide companies and financial institutions of all sizes with a risk management and disclosure framework to identify, assess, manage and, where appropriate, disclose nature-related issues.

The recommendations have been designed to be consistent with the language, structure and approach of the Task Force on Climate-related Financial Disclosures to enable integrated climate and nature-related reporting. They provide a set of recommended metrics and indicators to support assessment and disclosure and are currently voluntary.

Next steps for employers and trustees: Trustees should consider whether their investment managers intend to produce TNFD-compliant reports and the extent to which the risks highlighted in such reports affect scheme investments.

PENSION LEGISLATION AND REGULATION WATCH LIST

No	Topic	Effective date or expected effective date	Further information/action
1	Changes to DC scheme governance and disclosure	From 1 October 2023: Inclusion of explanation of illiquid investment policies in default SIPs and disclosure of asset allocation data in Chair's Statement.	DC schemes only. Consultation expected on draft regulations for phased introduction of new Value for Money framework for all DC schemes (excepting some small schemes). Draft regulations to extend CDC to multi-employer schemes expected Autumn 2023.
2	DB consolidation	Legislation "as soon as Parliamentary time allows", for new compulsory framework for superfunds	TPR updated interim guidance issued August 2023.
3	Changes to pensions tax allowances	Finance (No 2) Act 2023: removal of lifetime allowance charge (replaced with income tax charge on lump sums that could have triggered a charge) and changes to other allowances, from 6 April 2023.	Abolition of lifetime allowance and introduction of new tax-free cash allowances from 6 April 2024, through Finance Bill 2023-24.

No	Topic	Effective date or expected effective date	Further information/action
4	Draft DB Funding Code of Practice	Part 2 of TPR consultation and draft Code issued 16 December 2022; consultation closed 24 March 2023. Regulations and Code now expected to be in force from April 2024 but may be delayed until October 2024.	DWP regulations issued for consultation July 2022. Once in force, the Code will apply to triennial valuations submitted thereafter. Consultation on covenant guidance in 2023.
5	TPR General Code of Practice	Revised Code expected shortly.	All schemes.
6	New notification requirements for DB schemes in relation to corporate and financing activity and change to the notification process	Response to consultation on draft Notifiable Events (Amendment) Regulations was expected in Summer 2022.	TPR will consult on update to Code of Practice 2 (Notifiable Events) and accompanying guidance once DWP have published their finalised regulations and consultation response.
7	Pensions dashboards	Compulsory connection deadline of 31 October 2026 for all schemes with 100 or more active and/or deferred members at scheme year end between 1 April 2023 and 31 March 2024; staging timetable to be set out in DWP guidance. Application for deferral (in limited circumstances existing at 9 August 2023) must be made by 8 August 2024.	All registerable UK-based schemes with active and/or deferred members.

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