Compass

Winter 2021

Commentary on legislative and regulatory developments in pensions and employee benefits

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Autumn Budget 2021

The Chancellor's second Budget on 27 October 2021 was mostly quiet from a pensions perspective, but there were two announcements of significance. Preceding the Budget there had been some concern about a 'raid' on pensions tax relief (given current fiscal challenges), but this did not materialise.

Pensions tax relief for those on low income

It's pleasing to note that the Government has decided to grasp the nettle and address the anomalous treatment of non-taxpayers in occupational pension schemes (the vast majority of which use what is known as a 'net pay arrangement' to provide tax relief).

A non-taxpayer (someone earning less than the income tax personal allowance, currently £12,570, in a tax year) in such a scheme may be automatically enrolled if their earnings currently exceed £192 a week or £833 a month (equivalent to £10,000 a year income). However, they will not receive any tax relief on their employee contributions. In contrast, the same individual enrolled into a contract-based scheme, such as a group personal pension scheme (or an occupational pension scheme that operates the 'relief at source' system), would be credited with 20% income tax relief on their employee contributions.

The Government intends to fix this anomaly by introducing a system to make top-up payments directly to low-earning individuals saving in occupational pension schemes operating on a 'net pay arrangement' basis in respect of the 2024/25 tax year onwards. This should amount to an average top-up worth £53 in the 2025/26 tax year.

These top-ups will be paid after the end of the relevant tax year and only if the individual makes a relevant claim. This means that the first payments would only be made in the 2025/26 tax year and continue thereafter. While the process involves making a claim, HM Revenue & Customs (HMRC) will identify and notify any individuals that are able to claim using its records. For those who are "digitally excluded" HMRC is promising to provide additional support services to enable them to receive payment.

Charge cap review

At the Budget, it was announced that the Government would consult on further changes to the regulatory charge cap for defined contribution (DC) automatic enrolment pension schemes. This consultation has since been **published**. If the proposals are implemented, performance fees would be excluded from the charge cap, helping schemes overcome barriers to long-term investment and provide new opportunities to invest in areas such as British businesses and green projects.

Other news

- The Budget reaffirmed the plan to temporarily suspend the earnings element of the 'Triple Lock' used to uprate the State Pension and Pension Credit. Instead, for 2022/23 tax year the new and basic State Pension and Pension Credit will increase by the higher between CPI or 2.5%. CPI was higher this year so the increase will be 3.1% for the next tax year.
- The lifetime allowance of £1,073,100, the annual allowance of £40,000, the money purchase annual allowance of £4,000 and the tapered annual allowance provisions will all remain unchanged, as will the Individual Savings Account limit of £20,000 and the Junior ISA limit of £9,000.
- The income tax personal allowance of £12,570, the marriage allowance of £1,260, the dividend allowance of £2,000 and the personal savings allowances for basic and higher rate taxpayers will all remain unchanged.
- Income tax rates remain largely unchanged, but dividend rates are increased from 2022/23. As was announced in the previous Budget, Corporation Tax will increase from the 2023/24 tax year from 19% to 25% for companies on the main rate.
- National Insurance contribution thresholds will be increasing. The lower earnings limit rises from £120 per week to £123 per week (i.e., to £6,396 a year) for the 2022/23 tax year with consequent effect on automatic enrolment contribution calculations for those using the qualifying earnings basis. The primary threshold for earners increases from £184 to £190 per week for the 2022/23 tax year (i.e., to £9,880 a year). In addition, employee National Insurance rates will increase because the 1.25% increase for social care and the health service, previously announced, also applies from 2022/23 tax year.
- Employer's secondary National Insurance contributions are payable over the secondary threshold which increases from £170 to £175 per week (i.e., to £9,100 a year) and the rate also increases from 13.8% to 15.05% as a result of the 1.25% increase for social care and the health service.

Spotlight 2021/22, which covers this topic, is available, so please speak to your usual Capita contact if you wish to know more.

Climate change and pension schemes

The COP26 climate conference provides a major opportunity for the UK to make every endeavour to build an international consensus in achieving the goals of the Paris Agreement. With such a focus, the Department for Work and Pensions (DWP) has published a further consultation on reforms, while the Work and Pensions Select Committee in Parliament has asked the Government to push towards global harmonisation of climate-related financial disclosures and build a shared understanding of the role of pension schemes in achieving climate goals.

Climate and investment reporting: setting expectations and empowering savers

The **DWP's consultation** concerns changes that will apply to large pension schemes who are under the new reporting requirements in this area (i.e. schemes with more than £5bn assets currently and more than £1bn assets from October 2022). The proposal is to amend the legislation so that trustees of these schemes have to calculate and disclose a portfolio alignment metric setting out the extent to which their investments are aligned with the goal of limiting the increase in the global average temperature to 1.5 degrees Celsius above pre-industrial levels.

The DWP is consulting on:

- Draft amending regulations
- Draft non-statutory guidance explaining best practice for Statements of Investment Principles to describe trustees' climate change and stewardship policies; and
- Draft statutory guidance explaining the DWP's expectations about Implementation Statements which will need to describe how the scheme trustees have implemented these policies.

The consultation closes on 6 January 2022.

Climate reporting for businesses

Ahead of COP26, the Government announced the UK will become the first G20 country to mandate the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations for Britain's largest businesses to disclose their climate-related risks and opportunities. New legislation is expected to come into force from April 2022.

Work and Pensions Committee's recommendations

The Committee produced a **report** asking the UK Government to use the opportunity to build an international consensus on the role of pension schemes in addressing climate change.

The Committee has welcomed the Government's policy that divestment to reduce pension schemes' contribution to climate change should be a last resort. Instead encouraging behavioural change in companies through good stewardship is more likely to be an effective approach to help the real economy transition to net zero. It also views the Government's planned green taxonomy – a common framework for determining which activities of firms and investments can be defined as environmentally sustainable – as vital in tackling climate change and asks it to align with international standards as far as possible.

It recommends:

- As larger pension schemes are usually better placed to meet the costs of making green investments, consolidation is desirable and so the Pensions Regulator should report annually on the progress made in consolidating schemes.
- Schemes should be encouraged to consider setting net zero targets with the Pensions Regulator providing guidance on what net zero means.
- With a limited number of suitable green assets available for pension scheme investment, there is a risk of a 'green asset bubble' in the short term and so the Government should continue to support the development of products, such as green gilts, to mitigate that risk.
- The Government should set out a UK climate roadmap to provide greater certainty for pension schemes and other investors, particularly for those investing in long-term investments such as infrastructure.
- The DWP should set out what specific steps it's taking to ensure that its policies do not incentivise divestment over good stewardship—while making clear that schemes could nevertheless consider divestment when there is no other option.

Please speak to your usual Capita contact if you would like to discuss how these matters should guide your scheme's governance and investment policy.

Simpler annual benefit statements delayed until October 2022

The Government has delayed the introduction of simpler annual benefits statements until 1 October 2022, following industry concerns about the amount of work required to implement them.

Following its consultation in May, the Department for Work and Pensions (DWP) has published its **consultation response** alongside **regulations** and **statutory guidance** which require the trustees or managers of in scope schemes to provide annual benefit statements in a format that does not exceed one double-sided sheet of A4 paper. The idea is that this will enable members to easily understand:

- How much money they have in their scheme and what has been saved in it during the statement year
- How much money they could have when they retire
- What they could do to give themselves more money at retirement.

Scope

Initially, the requirements will only apply to defined contribution (DC) schemes used for auto-enrolment, although the DWP noted that a number of responses to the consultation suggested that the regulations should be broadened to include all DC schemes. The Government's response was that it will perform a review of the effectiveness of the simpler annual benefit statements before 1 October 2027, at which point it will consider the lessons learnt and whether it would be appropriate for the regulations to be extended to other kinds of scheme.

Statement template

Within the statutory guidance, the DWP has retained the proposed order and content of the five sections of the statements, as follows:

- Member and pension plan details
- How much money you already have in your pension plan
- How much money you could have when you retire
- What you can do to give yourself more money
- Find out more about your pension plan and how you can use your money.

Schemes can use their own branding, colour schemes and font size, but this should not obscure the flow of information nor increase the length beyond one double-sided sheet of size A4 paper. Additional material can be provided but this must be in a separate document to the statement itself with the statement being the first substantive document provided.

Costs and charges

In the consultation response, the DWP encourages trustees and managers to provide information on costs and charges on the face of the statement and states that it will continue to consider how best to present such information. The DWP noted that comprehensive, transparent and consistent charging information will enable members to become more engaged with their pensions. However, the provision of this information is not mandated.

Capita comment

Although the implementation date has been delayed, trustees of impacted schemes should not wait until the last minute before considering how to make the changes to their benefit statements. Substantial work may be required given the challenge of needing to find a way to condense a lot of important information into a much smaller space, while keeping everything clear, readable and easy to understand. Statements issued on or after 1 October 2022 will need to comply with the new requirements and so careful planning will also be required where there is a lag between the effective date of the statement and the date it is issued.

Although the requirements currently only apply to defined contribution schemes used for automatic enrolment, schemes not in scope are encouraged to apply the same principles as set out in the statutory guidance to their own benefit statements. Trustees and managers of other schemes may also wish to take the opportunity to review their own annual statements with a view to simplifying where possible.

Spotlight 2021/21 looks at these new requirements in further detail so please speak to your usual Capita contact if you would like a copy.

Taskforce on Pension Scheme Voting Implementation

The Taskforce on Pension Scheme Voting Implementation (TPSVI) was set up by the Pensions Minister in December 2020 to address problems in the voting of equity shares by pension schemes. The fact that it was set up is an indication of the importance of voting in broader stewardship of scheme assets, a core responsibility of asset owners generally and in particular large asset owners. It published its **report** on 20 September 2021.

Findings

The TPSVI focused on how to facilitate more voting by occupational pension schemes and raising the quality of voting by encouraging them to set voting policies. Its analysis found:

- Voting is of growing importance in securing value for pension savers of all kinds.
- There is enormous complexity in pension and investment structures which makes it hard for pension schemes to exercise control over voting.
- There is enormous complexity in how voting is delivered which again works against the interests of pension schemes.
- The TPSVI was told that there are many issues with splitting votes in pooled funds, but none appears to the TPSVI as material or insurmountable.
- There are significant problems with some stakeholder attitudes and the asymmetry of power between pension schemes and those such as fund managers and custodians.

Key principles for voting

The TPSVI asks that the Government, regulators and the pensions and fund management industry sign up to four principles:

1. Owners of all types of assets should be able to set expressions of wish on voting on a comply or explain basis which are actioned through the investment chain.
2. In responding to reasonable requests from parties in the same pensions chain, all stakeholders should be willing to operate on a “form over substance” basis where the reality of who does what takes priority over legal forms.
3. All stakeholders should be transparent as to the entitlements and restrictions in respect of voting that each of their products offer: transparency will drive choice.
4. All stakeholders in the voting chain must work in tandem to improve and deliver to savers – the system is only as strong as the weakest link.

The TPSVI made 24 detailed recommendations, set out in full in annex 2 of the report, including, but not limited to, the following:

- Trustees should either set their own voting policy or acknowledge responsibility for the voting policy that asset managers implement on their behalf.
- All fund managers should offer pooled fund investors the opportunity to set an expression of wish in a fund at the cost of implementation. Any costs for doing so should only reflect the marginal cost of operationalising the individual policy, and not the costs of upgrading IT and voting infrastructure to enable vote splitting.

- Government should, with legislation if necessary, encourage trustees to take more account of voting and engagement policies in appointment of fund managers.
- A vote disclosure template document should be encouraged.
- Investment consultants should be regulated as recommended by the Competition and Markets Authority to HM Treasury.

The Pensions Minister said: “I see no reason why trustees shouldn’t be able to determine their own high-level policies – on areas such as climate risk management, diversity, or pay – and find an asset manager to implement it. I congratulate the Taskforce for delivering a compelling and well-argued report. I will study the findings closely and respond at the earliest possible opportunity.”

Capita comment

This report is blunt and direct in dealing with the standing problems in this area, particularly in relation to pooled funds. It is now a challenge to the fund management industry in how to respond. Given the Minister’s enthusiasm we feel that this is likely to be an area for further legislative development. Trustees should discuss the report and its potential implications for their practices and thinking with their investment consultant at an early opportunity.

Please speak to your usual Capita contact if you would like to know more.

New Criminal Offences Policy and Code of Practice 12

The Pensions Regulator (TPR) has published a **criminal offences policy** on how it plans to use its criminal enforcement powers introduced in the Pensions Act 2021, and also laid before Parliament a revised Code of Practice 12. The Pension Schemes Act 2021 saw the introduction of three new criminal offences into the Pensions Act 2004: the offence of avoidance of employer debt, the offence of conduct risking accrued scheme benefits and the offence of failing to comply with a section 38 contributions notice (s.42A), all of which came into force from 1 October 2021.

The new criminal offences policy

The new policy is to provide guidance on TPR's approach to investigating and prosecuting the first two new criminal offences. The new offences in sections 58A and 58B of the Pensions Act 2004 can only be committed in respect of an occupational pension scheme which is not a money purchase scheme. The offences will not have a retrospective effect. Therefore, acts will need to have taken place on or after 1 October 2021 to be prosecuted. In order for the offences to apply, three components must be met.

The 'act elements'

Under section 58A, to meet the 'act element' a person must do or fail to do an act which:

- Prevents the scheme from recovering all or any part of the debt which is due from the employer under section 75 of the Pensions Act 1995.
- Prevents the debt becoming due.
- Compromises or otherwise settles that debt, or
- Reduces the amount of that debt which would otherwise become due.

Under section 58B the 'act element' is met if a person completes an act or engages in a course of conduct which has a detrimental effect, materially speaking, on the likelihood of accrued scheme benefits being received. For the purposes of this definition, accrued scheme benefits are benefits which have been accrued prior to the act or before the last act in a series. Benefits which are received from the Pension Protection Fund or under the Financial Assistance Scheme will be disregarded when an act is considered to be materially detrimental.

The 'mental elements'

A person must have intended their act to have the relevant effect in order to meet the 'mental element' under section 58A. By contrast, under section 58B, the 'mental element' is met where someone knew or ought to have known their act would have a materially detrimental effect.

Reasonable excuse

Even though a person may meet both the 'act element' and the 'mental element', they will not have committed an offence if they have a 'reasonable excuse'. The Regulator has indicated that a reasonable excuse will be specific to each case and circumstances applicable. It will consider each person's reasons for committing an act in isolation of other parties and will take account of the circumstances in which the act took place.

Process

- Following notification of an activity of concern, an initial assessment will be completed to decide whether or not the Regulator will engage their powers and undertake an investigation.
- Investigations will be conducted by the Regulator using all its regulatory information gathering powers.

- Following the information being gathered, an assessment of the powers and tools available will be completed to determine how to proceed. The Regulator will consider whether to use their criminal powers or their financial penalty powers.

The policy has a detailed illustrative case study which applies its principles to a fictional scenario.

Overlapping powers

The Regulator has many powers and some of these overlap. For example, action that is an avoidance of employer debt may be prosecuted as a criminal offence (per s58A of the Pensions Act 2004), may be subject to new stringent financial penalties of up to £1million (per s88A of that Act) and/or may be subject to a contributions notice (per s38 of that Act). In some cases, the Regulator has to choose, as the use of one power excludes the use of the other – the new financial penalties under s88A cannot be used where a prosecution is taking place or where a person is convicted.

Accordingly, the Regulator is consulting on its draft **overlapping powers policy, monetary penalty powers policy and information gathering powers policy**. This draft policy outlines how its regulatory and criminal powers may both apply in certain circumstances and how this will be approached. The draft policy outlines how statutory notices, financial penalties and prosecution will be considered to reach the correct outcome for each case. This includes case studies set out later in the document. The consultation closes on 22 December 2021.

Code of Practice 12

Following their **consultation response** on revisions to the Code of Practice 12, the Pensions Regulator has published its **draft Code 12** laid in Parliament.

The revisions result from changes to their Contribution Notice (CN) power in section 28 of the Pensions Act 2004. The Pension Schemes Act 2021 introduced two further 'act' tests, the employer insolvency test and the employer resources test, in addition to the existing material detriment 'act' tests. The aim of introducing the new tests to the CN power is to focus on the effect of an act on an employer, which in turn affects its capacity to support the scheme, thus offering an alternative route to engage the Regulator's CN powers. The revised Code sets out the circumstances in which the Regulator expects to issue a contribution notice where one or more of the tests are believed to be met. As noted, it will now be a criminal offence to fail to comply with a contribution notice.

The Code is supported by guidance that gives further detail and includes illustrative examples of how the tests will be considered in practice and the circumstances a contribution notice may be issued.

The Regulator has also updated its **clearance guidance** which relates to the voluntary process of applying for a clearance statement. Following a successful application for clearance, the Regulator confirms that it will not issue a contribution notice and/or financial support direction. The updated guidance reflects the developments in both the market and the way the Regulator operates since clearance was introduced in April 2005.

Capita comment

The new regime is one that deserves closer attention from trustees, sponsoring employers and, in particular, the owners of such firms. It is highly advisable to obtain specific guidance and training on how these matters may affect you.

Please speak to your usual Capita contact if you would like more information.

Pensions Regulator powers – notifiable events

Section 69 of the Pensions Act 2004 requires trustees and employers to notify the Pensions Regulator of prescribed events in respect of their pension schemes. To improve the Regulator's powers, the Government has launched a **consultation** on draft regulations which proposes to introduce two new employer-related notifiable events and remove one existing event. In addition, it is proposed that the new duty under section 69A of that Act will be brought into force to require employers and those connected with them (e.g. controlling companies and ultimate owners) to give updating notifications and make statements as matters develop in the case of the two new notifiable events and the one pre-existing event.

Two new employer-related notifiable events

The draft legislation proposes to introduce the following two new notifiable events:

Sale of a material proportion of the business or assets

The rationale behind this new notifiable event is that these types of transactions can indicate a change in covenant support for a pension scheme. Initial notification will be required when a 'decision in principle' to sell is initially made.

The definition of 'material proportion' for these purposes is where the sale of the business accounts for more than 25% of its annual revenue or the sale of assets accounts for more than 25% of the gross value of its assets. This will also include other disposals made or agreed in the previous 12 months of the notifiable event, which means several smaller transactions might be considered 'material' on aggregate.

Granting of security on a debt to give it priority over debt to the scheme.

The rationale behind this new notifiable event is that a scheme is more likely to receive a smaller amount of debt where security has been granted on a debt which has priority over a debt to the scheme. Again, the trigger for notification is a decision in principle.

'Relevant security' means a security of more than 25% of either the employer's consolidated revenues or its gross assets. It does not include the refinancing of an existing debt, security for specific chattels or financing for company vehicles. The Pensions Regulator is expected to provide more guidance on how to interpret this.

Removal of a pre-existing event

Wrongful trading will no longer be a notifiable event as the requirement to notify the Pensions Regulator has been acknowledged to be ineffective since a director is unlikely to ever admit to wrongful trading. Instead, it is hoped that the extension of the Pensions Regulator's powers brought under the Pension Schemes Act 2021 will provide more effective means to protect scheme members against bad conduct.

Amendment to existing notifiable event – intending to relinquish control

The proposal is to amend the existing notifiable event of a business owner or controlling company choosing to relinquish control of a sponsoring employer, so that the trigger for the duty to notify is where a 'decision in principle' is taken to relinquish control or (if no decision had been taken yet) an offer is made to the owners for it to relinquish control of a sponsoring employer.

New notice and statement

As mentioned above, the draft legislation would introduce a duty where a notice and statement must be issued to the Pensions Regulator when the 'main terms have been proposed' for either of the two new notifiable events described above or the reformed notifiable event of a controlling company relinquishing control. This duty falls on the sponsoring employer, any person connected to that employer and any associate of the employer.

Contents of the statement

As proposed, any such notification would have to be accompanied by a statement that describes:

- The event, including the main terms proposed
- Any adverse effects on the scheme
- Any adverse effects on the employer's ability to support the scheme
- Any steps taken to mitigate against those adverse effects
- Any communication with the trustees or managers of the scheme.

Importantly a copy of the notice and statement must be given to the trustees or managers of the scheme at the same time.

Next steps

The consultation closed on 27 October 2021. The Government has indicated that it will publish its response to the consultation within the next 12 weeks. The draft regulations are expected to come into force on 6 April 2022.

Capita comment

The draft legislation should result in both the Pensions Regulator and trustees becoming aware of and involved earlier on in the sort of corporate transactions which can have serious consequences for defined benefit (DB) pension schemes. While this is likely to be welcomed by trustees and pension scheme members, it will be a big change for corporates and their owners. A critical area is around price sensitive and confidential information. We think that corporates and their owners should focus early on achieving the right kind of confidentiality agreement with trustees. Corporates should not ignore the issue as the penalty for failing to comply is governed by the enhanced penalty regime and these penalties can be as high as £1 million, something that may focus minds.

It is unclear at this stage how many additional notices and statements the Pensions Regulator is expecting to receive and whether the changes will create extra resourcing needs. Also, there are currently directions in place for some notifications not to be necessary when both Condition A [assets are greater than pension protection fund (PPF) liabilities] and Condition B [no late contribution reports to the Pensions Regulator needed to be made in the last 12 months] are met. It is not clear if, and the extent to which, these provisions will carry forward in the new regime.

We have produced a Spotlight with more information on this matter. Please speak to your usual Capita contact if you would like to know more.

Driving value for money forwards for defined contribution (DC) savers

It has been a very busy few months for updates relating to value for member assessments. New rules are being brought in for relevant occupational pension schemes, which cover the majority of DC schemes, and with additional, more onerous, requirements applying for smaller relevant schemes. The Financial Conduct Authority (FCA) has also finalised its new rules on value for money assessments which will apply to FCA regulated workplace pension schemes. There is a fair degree of overlap between the two suites of rules so the regulators have also joined forces to publish a discussion paper on how to develop a consistent framework for value for money to apply across workplace and non-workplace schemes, along with what metrics and benchmarking would be needed to allow easy comparison of performance.

DWP guidance on value for member assessments for relevant DC occupational schemes

The Department for Work and Pensions (DWP) has issued **guidance** on the value for members assessment requirements, which came into force from 1 October 2021 and were legislated for under the Occupational Pension Scheme (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021. As a reminder:

- All 'relevant' pension schemes, which includes most DC pension schemes, must calculate and state the return on investments from both default and self-select funds, in addition to the existing requirement to declare net transaction costs and charges. This applies, regardless of the size of the scheme assets, for the first scheme year that ends after 1 October 2021. The return on investments has to be published on a website and included in the first Chair's Statement, the deadline for which is seven months after the relevant scheme year end.
- 'Relevant' schemes with under £100 million of total assets, which have been operating for three or more years, must carry out a more detailed assessment of how their scheme delivers value for members. The assessment must include a comparison of reported costs and charges and fund investment (performance) net returns compared against three other larger schemes, as well as a self-assessment of scheme governance and administration criteria. Trustees must also have discussions with at least one of their comparator schemes about a transfer of the member's rights should their scheme be wound up. This must be completed for the first scheme year which ends after 31 December 2021 and again must be published on a website and included in the first Chair's Statement, the deadline for which is seven months after the relevant scheme year end. The outcome must also be reported to the Pensions Regulator in the annual scheme return.

The guidance has details of what is expected for each part of the value for members' assessment.

Spotlight 2021/12 has further detail on the background to these changes. This is available on request from your usual Capita contact.

FCA's final rules on value for money assessments for FCA regulated workplace pension schemes

The FCA has published final rules (**PS21/12**) on how Independent Governance Committees (IGCs) and Governance Advisory Arrangements (GAAs) should compare the value of pension products and services and promote the best value for consumers.

This latest policy statement summarises feedback received in response to the FCA's consultation (**CP20/9**) on driving value for money in pensions, which was published in June of last year. It sets out that the FCA is going to proceed with new rules requiring IGCs to:

- Consider three key elements of value for money - costs and charges; investment performance; and quality of services (including member communications).
- Assess and report on value for money through comparison with other options on the market.
- Weigh up whether an alternative scheme or schemes would offer better value for money and inform the pension provider or the pathway investment provider if so. If the IGC is unsatisfied with the pension provider's response, the IGC should also inform the relevant employer where this could make a difference to the outcome of scheme members.
- Set out their overall assessment in their reports about whether the scheme or pathway investment provides value for money.
- Explain how they have assessed value for money in their reports and keep evidence for at least six years.

The new rules came into force immediately from publication on 4 October 2021 with firms and IGCs having until 30 September 2022 to publish their next report and then annually by 30 September thereafter.

Spotlight 2021/20 looks at the final rules in more depth and is available from your usual Capita contact.

Joint discussion paper from the regulators on a future 'value for money' framework

The FCA and the Pensions Regulator have published a **discussion paper** on developing a common framework for measuring value for money in DC pension schemes, both workplace and non-workplace pension schemes.

It is proposed that schemes should provide further transparency around three key areas - investment performance, scheme oversight (including data quality and communications) and costs and charges. The ambition is for trustees and IGCs to use the framework to compare their scheme with similar schemes, making their data publicly available annually. Therefore, the focus of the paper is on the different possible metrics and benchmarking which could be used to allow a comparison against the three key areas.

A feedback statement is due in 2022 which will set out the next steps, hopefully with a timeframe, for the introduction of the common framework.

Further detail on the discussion paper is set out in Spotlight 2021/18 which is available from your usual Capita contact.

Capita comment

It is clear that value for member (or value for money) assessments are here to stay.

In the occupational world, the requirements have been gradually built up over time since they were first introduced in 2015. The latest new requirements for smaller DC schemes are part of the Government's focus on consolidation, as it wants members in well governed schemes that deliver the best value for members over the long term. Schemes that cannot demonstrate good value for members need to consider winding up and transferring the members' rights to another scheme that does offer good value.

The FCA is just catching up in publishing its final rules but the flavour is much the same and reflects the Government's ambitions. The joint discussion paper on the framework from both the regulators sets out that the drive is for a consistent approach to how this is done in both regulatory spaces. There is not yet a timeframe attached to when any changes may be made but the one thing that looks certain is that the requirements will evolve further.

Public service pension schemes - new tax remedies

Between 1 April 2014 and 1 April 2015, the Government moved public service pension schemes from a final salary benefit structure to a career average revalued earnings scheme (known as 'CARE Schemes'). One of the changes made during the pension reform was to provide a benefit protection for older members, but this protection has since been found to be discriminatory on the grounds of age and is now being extended to all members who would otherwise have been eligible if the benefit protection had not contained an age restriction.

Implementing the remedy to rectify the unlawful age discrimination may result in members who are due compensation facing adverse tax charges. The Government, therefore, intends to modify existing legislation to mitigate the impact on individuals affected by the age discrimination identified. The proposed modifications will come into effect from 6 April 2022 and:

- Provide an exemption to a tax charge on the compensation a person may receive if, following the remedy, they are owed money
- Allow a person to protect their pension rights from lifetime allowance charges calculated on any benefit improvement the person might receive because of the compensation
- Allow additional annual allowance to be available so that a person will not pay more annual allowance charges than they would have done if the discrimination hadn't occurred
- Where an unfunded public service pension scheme has paid lifetime allowance or annual allowance charges on behalf of a member, but that benefit is now under a different scheme, for the payment to be deemed to have been paid by the latter scheme
- Ensuring that payments of pensions and lump sums that would have been authorised payments had they been made at the relevant time, are treated as meeting the conditions to be authorised.

Capita comment

While these changes will deliver the commitments the Government set out in its response to the **Public service pension schemes consultation: changes to the transitional arrangements to the 2015 schemes**, it is a departure from past precedence. For example, in the remediation of the Government Actuary's Department (GAD) v Milne Pensions Ombudsman determination where it was determined that certain firefighters and police officers had been underpaid their retirement lump sums due to a failure by GAD to review the relevant commutation factors; while the affected people did not have to pay an unauthorised payments charge, administrators still needed to calculate and report the unauthorised payments charge to HMRC.

Removing the requirement to assess whether a revision to benefits results in an unauthorised payment or which scheme has paid lifetime allowance or annual allowance charges during rectification work is a welcome administrative easement. However, some may question why affected members should be able to protect the pension benefit increases that arise from the extension of the benefit protection against lifetime allowance charges. The member didn't lose part of their lifetime allowance as a result of the discrimination, so why provide extra lifetime allowance?

Although the reasoning for protecting increases to benefits arising from the remedy is not apparent, it could be a method of providing compensation to those affected by the discrimination or a recognition that some public service workers like doctors and consultants already find the limits on their pension pots to be a disincentive to a continuation in their profession. So the groups of members who'll benefit from this provision will welcome this news.

Round up of recent pension news

Here we turn our attention to some other recent industry news.

Consultation on a change to the Guaranteed Minimum Pension (GMP) fixed rate revaluation rate

The Department for Work and Pensions (DWP) has **consulted** on a change to the fixed rate of GMP revaluation for early leavers. The revaluation rate is reviewed every five years so this change is proposed as part of a periodic review and follows advice from the **Government Actuary's Department**. Under the proposals, the rate would move from 3.5% pa to 3.25% pa for early leavers with a GMP who leave service between 6 April 2022 and 5 April 2027.

PPF consults on 2022/23 levy

The Pension Protection Fund (PPF) has **consulted** upon the levy rules for 2022/23 setting out how it proposes to calculate the levy invoices which will be issued in Autumn 2022. The headlines from the press release that accompanied the consultation were:

- Key elements of the PPF's levy methodology will remain unchanged because of the PPF's strong funding position
- The levy estimate for the next levy year is £415m, which is down by £105m from £520m for the 2021/22 levy year. The decrease is a result of improved scheme funding and stability in the levy rules
- 82% of schemes that pay a risk-based levy will see a reduction, though those with worsening covenant positions may see an increase in the levy
- Measures introduced in 2021/22 to support schemes through the pandemic will remain in place.

Latest news on actuarial valuations of public service pension schemes

The Government has made two announcements impacting public service pension scheme valuations.

2016 valuations – amending directions

Following uncertainty arising from the McCloud/ Sargeant litigation, the cost control element of the 2016 public service pension scheme valuations had to be paused. The Government has now published **amending directions** which allow the completion of the 2016 valuations. The legislation sets out how schemes should complete the cost control element to account for the impact of the McCloud/Sargeant litigation.

2020 valuations – cost control mechanism

The cost control mechanism is designed to balance the risk between members of public service pension schemes and the Exchequer. Following a **consultation** on the proposed reforms of the mechanism which was covered in the **Autumn edition of Compass**, the Government has announced all three reforms will proceed.

The new approach will see the following changes:

- A reformed scheme only design: This design will remove any allowance for legacy schemes in order to ensure the mechanism only considers past and future service in reformed schemes

- A widening of the cost corridor from +/-2% to +/-3% of pensionable pay
- The introduction of an economic check: A check which is linked to expected long-term GDP aimed at ensuring a breach of the mechanism would only be implemented following consideration of long-term economic assumptions.

The Government is aiming to implement these reforms in time for the 2020 valuations.

Small pots – first report from Small Pots Cross-Industry Co-ordination Group

Convened jointly by the Pensions and Lifetime Savings Association (PLSA) and the Association of British Insurers (ABI), the Small Pots Cross-Industry Co-ordination Group ('the Group') was formed in March 2021 to address the proliferation of small, deferred defined contribution (DC) pension pots in the UK. In its **first report**, the Group highlights several disadvantages associated with very small, deferred DC pension pots (defined as less than £500), such as worse value for money and less favourable charging structures for savers compared with larger pots, with lower engagement from members which increases the likelihood of providers losing contact with members and general inefficiencies for pension providers leading to increased administration costs.

For context as to the scale of the problem, the Group estimates that more than 3 million savers currently hold deferred DC pension pots worth less than £100 and that 10.5 million savers hold pot sizes under £1,000.

The Group's initial update report discusses three possible models which could be used to introduce a form of automatic consolidation of deferred pots:

- Pot follows member – under this approach when an employee moves jobs, if certain criteria are met then their deferred DC pot would automatically be transferred, unless the individual opts out
- Default consolidators – under this model small, deferred DC pots would be automatically transferred into a single consolidator scheme, thereby creating a master pot for members who have accumulated numerous pots through automatic enrolment.
- Member exchange – providers with small, deferred DC pots would use a data service to look for matches where another provider has the same member making active contributions and where a match is identified, the deferred DC pot would be transferred, unless the individual opts out. This is similar to the pot follows member approach.

The report recommends that further feasibility studies be conducted to assess the impact of the various models on savers and the automatic enrolment market. It provides a roadmap for progress which hopes for the staged implementation of a consolidation model to begin by 2025. The report also encourages the industry to continue to work towards same-scheme consolidation where possible in the meantime.

FCA writes to defined benefit pension advice customers of firms in liquidation regarding FSCS compensation

The Financial Conduct Authority (FCA) has **written** to over 3,500 consumers of firms currently in liquidation where past business reviews of defined benefit (DB) pension advice have identified that the firm has given unsuitable advice to some customers. The FCA's website has a list of firms that are in insolvent liquidation and have given unsuitable advice to some customers.

A copy of the letter template has also been published. It contains a call to action that individuals may be entitled to compensation if the advice received was unsuitable and outlines how customers can make a claim to the Financial Services Compensation Scheme (FSCS). The letters also direct customers to the FCA's DB pension transfer advice checker to help them decide whether the advice they received was suitable or not.

This call to action is part of the FCA's work to support consumers who have received unsuitable DB transfer advice to receive appropriate compensation.

Thank you for reading.

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