Pension Schemes Act 2021 – Impact for defined benefit pension scheme sponsors and trustees

October 2021

What is changing and when?

The Pensions Schemes Act 2021 will make significant changes to the legal and regulatory landscape in the UK in a wide range of areas. Here we look at what is coming in and when and the most immediate practical issues for defined benefit pension scheme sponsors and trustees.

New Act at a glance	When in force
New criminal offences applicable to directors, trustees and wider stakeholders: where there is, without reasonable excuse, 'wilful or reckless' behaviour or 'failure to act' which adversely affects a DB scheme, which could attract prison sentences of up to 7 years and/or unlimited fines.	1 October 2021
Increased powers for the Pensions Regulator: expanding the circumstances in which the Pensions Regulator ("TPR") can require payments to the pension scheme from entities associated or connected to a sponsor (e.g. other group companies) – known as contribution notices. TPR will also have extended information-gathering and new interviewing powers.	1 October 2021
Greater oversight and scrutiny of corporate activity: the new requirements increase the need to reflect on and explain the pension impact as events occur including dividend payments, refinancing and restructuring activities. And more events will need to be notified to TPR (e.g. material sales, granting security ranking above pension scheme) with fines up to £1m for failure to do so.	1 October 2021 (new TPR notification requirements Q1/2 2022)
Potentially more stringent scheme funding regulation: includes tougher funding standards and higher contributions to potentially eliminate scheme deficits faster.	Q2 2022
More member protection: new restrictions on the right to a statutory transfer, unless prescribed conditions are met.	Autumn 2021 (consultation closed 10 June 2021)
Additional ESG requirements: new climate change governance and disclosure requirements for pension schemes.	October 2021 (consultation closed 31 August 2021)
New type of pension scheme: 'collective money purchase schemes' where member and employer contributions are invested collectively.	TBC (consultation closed 31 August 2021)
Pensions dashboard: a new platform allowing individuals to view all their pension information in a single place.	2023

Update on Regulations and TPR Guidance

Much of the detail behind these new measures will be set out in regulations and related TPR guidance.

During the course of 2021 DWP and TPR have issued various draft regulations and guidance on a number of areas covered by the PSA 21, however final details remain outstanding.

But there are some practical points of detail to bring out:

- The expanded contribution notice powers build on a current regime which includes the power to 'look back' up to 6 years when assessing whether to use its powers.
- Whilst the new offences will not apply retrospectively, TPR notes in its draft policy that evidence pre-dating their commencement may be relevant to its investigation or prosecution if, for example, it indicates someone's intention.
- Given the 'commonalities' between the offences and TPR's power to issue a contribution notice, TPR intends to take a similar regulatory approach when assessing potential liability and so TPRs current codes of practice and guidance will be relevant here.
- Pensions will need to be considered at an earlier stage in the transaction timetable given the greater oversight TPR will have over over corporate activity.

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A stronger TPR: the impact of corporate activity on pension schemes is a key focus

Who does this impact?

DB scheme sponsors and their wider groups (including individual directors, trustees and their advisers) involved in corporate activity that could adversely affect or materially reduce the financial resources supporting their DB scheme. For example they may include events such as:

- Sale of a group company or part of its business,
- Transferring a material part of the balance sheet to another group entity, either UK or overseas,
- Changing the intra-group debt structure,
- Raising additional finance ranking ahead of the pension scheme,
- Payment of material dividends, special dividends or share buybacks.

Be prepared for the additional process required by the new regulations

To avoid scrutiny and sanctions, company directors and trustees need to demonstrate that they have taken the right steps and advice in a timely manner. A robust governance framework will be key to mitigate the risks.

Suggested framework to manage risks associated with corporate activity

1. Identify risks

Could the event impact the sponsors' ability to support the scheme, either through future contributions, ability to underwrite the risks, or the return to the scheme on insolvency.

2. Analyse

Is the impact material and does it warrant any further analysis to determine the extent to which the sponsor covenant is impacted, e.g. a materiality assessment may consider the size of the event in the context of the business and the scheme.

3. Assess

Assess wider implications – Is there any potential interplay of the event with the sponsors ability to meet any other scheme related obligations e.g. a guarantee to the scheme.

4. Act

Decide on action – If there is a material impact on the covenant, notify the relevant stakeholders and decide if mitigation actions are required, e.g. accelerating contributions, additional security, new funding commitments.

5. Evidence

Document the process followed and rationale behind action, on the assumption that it will be available to all parties. TPR's consultation is clear that they will review contemporaneous records e.g. board minutes and supporting analysis showing the appropriateness and rationale when deciding whether to use their powers.

What are the headline impacts of the other changes under the Act for DB sponsors?

New funding regime and investment strategy

Notably, the funding and investment strategy needs an employer's agreement and this potentially changes the balance of power e.g. until now trustees have only been required to consult with employers on investment matters. The detail on this remains to be seen.

Importantly this change to the funding regime also includes tougher funding standards and higher contributions to potentially eliminate scheme funding deficits faster. More details will be published in further regulation later this year.

Climate change

The act introduces a number of requirements in relation to climate change. Whilst this will be owned by trustees, employers will want to ensure their approach is consistent with the wider corporate ESG strategy.

Appendix – Pensions Act 2021

Summary of the key implications of the Act

1

Wider financial sanctions

The Act widens the circumstances in which the TPR can impose financial sanctions (e.g. a 'contribution notice') on a party. This can be realised in the additional two circumstances:

- **Employer insolvency test** – Where an act or failure to act 'would have materially reduced the amount of cash or assets likely to be recovered by the scheme' in the event of employer insolvency (also known as a section 75 debt).
- **Employer resources test** – where an act or failure to act 'reduced the value of the resources of the employer' (ie profits before tax, adjusted to exclude the effect of non-recurring or exceptional items) and 'that reduction was a material reduction relative to the amount of section 75 debt in relation to the scheme'.

The full impact of these new circumstances is currently unclear but they could have a far reaching impact on scheme employers and those connected or associated with them.

A statutory defence to these tests may apply if parties can show the have: considered the issue; taken steps to minimise any impact and reasonably concluded that there would not be such a reduction in Scheme support.

2

New criminal offences

New criminal offences have been implemented which can attract an unlimited monetary penalty fine and/or 7 years' imprisonment, including:

- Offence of avoidance of employer debt.
- Offence of conduct risking the members accrued benefits.

We note the following compared to the previous circumstances:

- These new offences put a level of scrutiny on individuals running the scheme that was not there before.
- The Government has confirmed that criminal convictions will not be retrospective in nature.

3

Increased reporting requirements: notifiable events and accompanying statement

Companies are required to notify of certain events relating to the DB scheme and/or the employer e.g. existing employer events include breach of a banking covenant or a decision to cease trading. From 1 October failure to notify could lead to fines up £1m.

The Government is proposing three new events that will trigger the requirement to both notify TPR and prepare an accompanying statement the pension scheme impact of:

- Material business or asset sales,
- Granting security ranking above a pension scheme, and
- A change of control of a pension scheme employer.

These requirements and the need to prepare an accompanying statement are likely to bite at an earlier stage in the transaction timetable:

- Initial notification needs to be on making an "in principle decision", and
- The second notification and accompanying statement needed when terms are proposed not agreed

We understand these changes are likely to come into force in Q2 2022.

4

Strengthened regulatory powers

- New information gathering powers and stronger investigative powers (interviews, inspection of premises).
- Harsh new penalty for non-compliance, which includes punitive (civil) fines of up to £1 million for serious breaches of pensions legislation.

5

Environmental, social and governance (‘ESG’)

To support the Government’s commitment to achieve a net zero economy by 2050, the Act also introduces a number of requirements for schemes in respect of climate change:

- Reviewing the exposure of the scheme to such risks.
- Developing a strategy for managing the risks.
- Measuring performance against those targets.
- Publishing certain information relating to the effects of climate change.

6

Changes to defined benefit scheme funding requirements

- Scheme trustees are now required to produce a funding and investment strategy specifying which investments the trustees intend to hold.
- A new Code of Practice has been consulted on and is expected to be issued by TPR before Spring 2022, which will potentially add to the list of changes.

7

Other changes introduced

- **Pensions dashboard** – a new platform which allows individuals to aid their retirement planning by viewing all their pension information in a single place.
- **Collective defined contribution schemes** – an alternative pension design to traditional defined benefit and defined contributions schemes. There are risk sharing plans used in many other countries.
- **Members leaving pension schemes** – additional restrictions on members leaving the pension scheme (to stop scams), including the requirement for the members to provide the pension scheme with additional evidence or information about their ability to transfer benefits.
- **Administration charges** – the definition of administration charges has been widened as the Department for Work and Pensions received questions asking for clarification on the definition.