CMS Pensions Briefing
DC Schemes and Master Trusts

April 2021

Welcome to our second regular briefing on topical issues facing defined contribution (DC) pension arrangements.

In this briefing we explore, amongst other things, TPR's recent DC schemes survey, a first look at collective DC schemes, some new disclosure and transfer proposals and the long-awaited arrival of pensions dashboards.

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A focus on…

TPR's 2020 DC schemes survey

On 2 February 2021, TPR published the results of its 2020 DC Schemes Survey. The survey was carried out between January and March 2020. It included interviews with individuals involved in managing 200 single-employer and multi-employer schemes, as well as 16 master trusts.

Objectives

The key objectives of the survey included monitoring DC scheme compliance with two key governance requirements (KGRs), being:

— KGR 2, which requires trustee boards to assess the extent to which charges and transaction costs provide good value for members; and

— KGR 5, requiring trustee boards to ensure that their default investment strategy is suitably designed for their members.

Other objectives included:

— To better understand current administration practices and strategies, as well as the relationship between trustees and scheme administrators; and

— To monitor the extent to which DC schemes were meeting new duties introduced by the Competition and Markets Authority on setting strategic objectives for investment consultants and tendering for fiduciary management.

Key findings

The percentage of members in a scheme that met KGR 5 requirements rose from 90% to 95% between 2019 and 2020, although there was a fall in the number of members who were part of a scheme meeting KGR 2 requirements from 80% to 58% over the same period. Perhaps unsurprisingly, the larger a scheme was, the more likely it was to meet the requirements under both KGRs.

The survey found that 43% of those schemes which have over 100 members and which are being used for auto-enrolment considered climate change in their investment strategies, more than double the figure of 21% in 2019. Of those that did not consider climate change in their investment strategies, the most common reason was that they did not feel it to be relevant to their scheme. However, a nearly equal number (19%) stated that they were planning to review whether they should start taking account of climate change in future investment strategies. In a press release accompanying the survey results, TPR highlighted that the new Pension Schemes Act 2021 will significantly increase the expectations placed on trustees to consider and address climate risks and opportunities in the future. TPR also announced that in the spring it will publish a strategy for how TPR will help trustees to meet climate change-related challenges.

Other findings included that only 16% of schemes discussed administration at trustee board meetings every quarter, although 74% of schemes did this annually. As well as this, more than a third of schemes surveyed did not measure the performance of their administrators and more than half had little knowledge of their accreditations and standards.

Our thoughts on...

New DC Disclosure and Transfer Requirements – a nudge in the right direction?

The Department for Work and Pensions (DWP) published a paper (referred to as 'A Stronger Nudge') in October 2020 setting out the government's policy intention to encourage pension savers in occupational DC schemes to take pensions guidance in certain circumstances. The paper confirms that the government will make regulations imposing requirements on trustees of occupational pension schemes in connection with the guidance.

What are the new duties?

The proposed duties are twofold. Firstly, when a scheme beneficiary applies to transfer their pension rights or to start receiving "flexible benefits", trustees will be required to refer the member to Pension Wise. Secondly, when either of these applications are made, trustees will need to ensure that the member has either received guidance from Pension Wise or has opted out of receiving it.

What is the reasoning behind these changes?

The DWP believes that while Pension Wise guidance is a valuable service, it is failing to reach enough people and the new proposed regulations will aim to address this. In small scale trials with three pension providers testing the effect of imposing these duties, it was found that taking these steps led to a significant increase in the number of members who booked and attended a Pension Wise appointment.

How might this work in practice?

It is intended that trustees should have flexibility in how to adopt practices to comply with these new duties, and TPR is expected to provide its own guidance on this in due course.

One of the proposals in the paper is to create regulations requiring trustees to incorporate appointment bookings with Pension Wise as part of their engagement process so that members will then be able to confirm that they have received the guidance or, alternatively, opt-out of the service.

Next steps

The DWP plans to hold consultations on the detail of draft regulations relating to these new duties in due course, though at the time of writing we are not aware of a proposed publication date. The FCA will also be holding consultations on rules implementing the Stronger Nudge on contract-based pensions.

Given the ongoing difficulty of balancing the desire to allow members to transfer without undue hindrance with the policy intention of ensuring proper safeguarding before they choose to do so, it will be interesting to see the form of the proposed regulations when they are finally available, and in particular the extent to which the DWP push for the Pensions Wise guidance process to be brought into the legal framework as a default. What is clear is that as things stand - and several years after its introduction - the industry still has a great deal to do to ensure that savers have wised-up to the availability and the value of the guidance process.

On the horizon…

What could the future hold? A look at CDC…

Most of the industry noise around the new Pension Schemes Act 2021 has focussed on the new TPR powers – particularly the criminal offences, the new requirements on long term scheme funding and the eye-catching provisions for pensions dashboards and climate change reporting. However, the majority of sections in the new Act are not about any of those issues but instead introduce a framework for a completely new type of occupational pension scheme in the UK: collective money purchase/DC schemes, commonly referred to as "CDC" schemes. Similar forms of CDC scheme already exist in the Netherlands, Denmark and Germany, but would be a marked change in how pensions are provided by employers in the UK. Royal Mail is expected to be the pioneer in developing and implementing a CDC scheme.

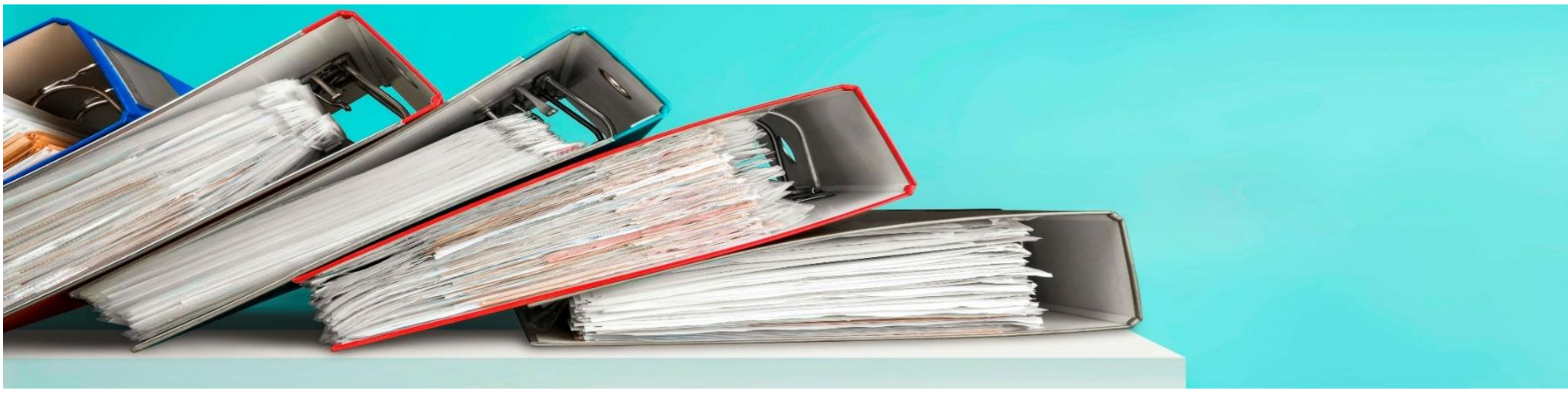
So whilst much of the detail remains to be confirmed in future regulations, we'll take a look at the idea, what these schemes will look like and how they will be funded, authorised and taxed.

A new idea

The idea behind a CDC scheme is that whilst members are building up benefits the contributions are defined – like a normal DC scheme. However, by pooling assets and liabilities the scheme offers members a target defined benefit which is paid from the scheme when the member retires. This should result in a smoothing of market volatility.

Unlike a standard DB pension scheme the defined benefit is not guaranteed – it is just a target – and members can receive lower benefits if the funding level does not support the target. The key point from an employer's perspective is that it has no funding obligation other than for the defined contributions and any expenses it agrees to pay. From a member's perspective, CDC might be simpler than DC – as no choices about investment or retirement provision will need to be made.

One current proposed restriction for CDC schemes is that they will need to be an occupational pension scheme in which only connected employers participate – so not a master trust for unconnected employers. However, there is already talk in the industry about the possibility of extending the CDC concept in order for it to work for groups of unconnected employers, and so it is possible that this restriction will be relaxed once the first schemes are up and running.



Authorisation and funding

A CDC scheme must be authorised by TPR before it can be operated. Whilst we don't have the detail for the authorisation process yet, the key requirements for authorisation are set out in the Act and, unsurprisingly, are expected to be similar to the requirements under the DC master trust authorisation regime.

Following an application for authorisation TPR will have six months to make a decision and will need to consider a number of factors. In particular, TPR will need to be satisfied that the following requirements are met:

— Fit and proper persons: founders, trustees and those with power to remove and appoint trustees must be fit and proper.

— Sound scheme design: trustees will need to prepare a "viability report" and obtain scheme actuary certification.

— Financial sustainability: the scheme must have sufficient financial resources to meet the costs of setting up and running the scheme. It must also have the resources to be able to run the scheme on for up to 2 years following a "triggering event".

— Adequate systems and processes for communicating with members: as the benefit structure is going to be completely new there is going to be a focus on ensuring that members of CDC schemes understand the target nature of the benefits.

— Effective operation: which will need to cover IT systems and risk management processes.

— Continuity strategy: a plan for how members' interests will be looked after if a "triggering event" occurs.

Like a DB pension scheme, trustees will need to obtain actuarial valuations, although for CDC schemes they will be at one-year intervals. The big difference between the funding of CDC and DB pension schemes is that, in a CDC scheme, if a valuation shows that it is underfunded, it is the benefits which are to be adjusted. There is no obligation on the employer or the members to top up the funding if the CDC scheme is underfunded, as increases to pensions and other benefits are not guaranteed (but will depend on the funding of the scheme).

TPR supervision

In addition to authorising CDC schemes, TPR will gain a range of new powers in relation to them.

Key powers include:

— Directing trustees to obtain an actuarial valuation or to adjust benefits in accordance with their scheme rules.

— Issuing risk notices to trustees where TPR is concerned that they may breach the authorisation criteria.

— Requiring notification of "significant events" affecting the scheme.

— Withdrawing authorisation for a CDC scheme.

Triggering events

The Act contains a list of "triggering events" which result in various consequences for CDC schemes. Examples of these include the insolvency of an employer, the start of wind-up for the scheme and a notice from TPR that it is withdrawing authorisation.

Where a triggering event occurs, trustees are required to pursue one of the following three continuity options and to produce an implementation strategy to be approved by TPR. In some cases, for example if authorisation is withdrawn, there is no choice and the trustees must follow the first option:

— Discharge the liabilities by transferring the value of each member's rights to another scheme (including a DC master trust) or securing those rights with an insurer and then initiating wind-up of the scheme.

— Resolving the triggering event, in which case the trustees must notify TPR when they believe it has been resolved and will need to receive confirmation from TPR that it is satisfied with that resolution.

— Conversion to a closed scheme.

Taxation

As the benefits from a CDC scheme are different to a DB pension scheme (where the benefits cannot generally go down) and also different to income drawdown, tax legislation needs to be amended to allow CDC scheme benefits to be paid without triggering unauthorised payment charges.

A quick guide to…

Climate Risk Update

In our first publication we focussed on the DWP consultation "Taking action on climate risk: improving governance and reporting by occupational pension schemes" issued in August 2020 which was launched in anticipation of the Pension Schemes Act 2021 coming into force.

To recap, the DWP identified two main risks in the consultation:

1) physical risk e.g. rising sea levels and extreme weather events, which can affect and threaten physical assets and disrupt supply chains; and
2) transitional risks e.g. the risks associated with action to tackle climate change.

The consultation closed in **October 2020**.

The Pension Schemes Act 2021

The Pension Schemes Act 2021 (the Act) received Royal Assent on 11 February 2021. The Act inserts new sections into the Pensions Act 1995 providing for regulations requiring occupational pension schemes to manage the effects of climate change as a financial risk and to report on how they have done so in line with TCFD recommendations. A compliance framework regarding the new duties will be put in place including additional powers being given to the Pensions Regulator.

All authorised master trusts and authorised collective money purchase schemes will be subject to the requirements from 1 October 2021, regardless of size. The government will take stock in 2023 and will consult on extending the requirements to all schemes in 2024, following an interim review.

The aim of this new legislation is to ensure that trustees of the biggest pension schemes limit the risk climate change poses to their members' benefits and to support the government's Green Finance Strategy under which all large asset owners will make disclosures in line with TCFD suggestions by the end of 2022. The long-term objective is to protect members' benefits against the risks identified in the August 2020 consultation.

However, debates in the House of Lords prior to the Act coming into force noted that the intention is not for the government to direct schemes or set their investment strategies.

The detail

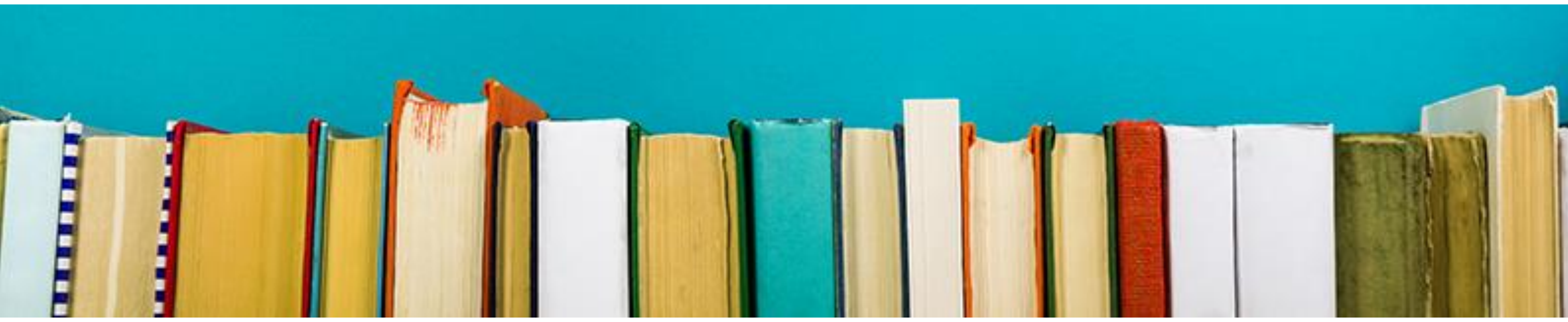
The Act gives the government the power to make regulations to impose requirements on trustees to ensure effective governance of the scheme in light of the effects of climate change. Those draft regulations were the subject of a consultation which ran from January to March this year.

Proposed trustee duties under the draft regulations

The response to the consultation confirms that trustees who are subject to the new requirements will have the following ongoing duties:

- **Governance and risk**: trustees must establish and maintain oversight of the climate-related risks and opportunities which are relevant to the scheme. They must also establish and maintain processes for satisfying themselves that those undertaking governance on their behalf are taking adequate steps to identify, assess and manage climate-related risks and opportunities.
- **Trustee Knowledge and Understanding**: trustees must have the appropriate degree of knowledge and understanding of the principles relating to the identification, assessment and management of climate change risks and opportunities to enable them to properly exercise their functions.
- **Strategy**: trustees must identify and assess the impact of climate-related risks and opportunities which they consider will have an effect over the short, medium and long term on the scheme's investment and funding strategy.
- **Scenario analysis**: trustees must undertake scenario analysis, assessing the potential impact on the scheme's assets and liabilities, the resilience of the scheme's investment strategy and the scheme's funding strategy for at least two scenarios, one of which corresponds to a global average temperature rise of between 1.5 and 2 degrees centigrade inclusive on pre-industrial levels.
- **Risk management**: trustees must establish and maintain processes for the purpose of enabling them to identify, assess and effectively manage climate-related risks which are relevant to the scheme.
- **Metrics**: trustees must select and calculate an absolute emissions metric and an emissions intensity metric in respect of the scheme's assets. Trustees must also select one additional climate change metric to calculate in respect of the scheme's assets.
- **Targets**: trustees must set a non-binding target for the scheme in relation to at least one of the metrics they have selected to calculate.
- Disclosure: Trustees will be required to publish their TCFD report on a publicly available website, accessible free of charge. To govern this reporting, trustees will be required to provide TPR with the website address for their most recent TCFD report, Statement of Investment Principles and Implementation Statement.

Trustees must carry out scenario analysis and obtain data to calculate their chosen metrics '*as far as they are able*' to, meaning that trustees are expected to take all such steps as are reasonable and proportionate in the particular circumstances taking into account the costs incurred, or likely to be incurred, by the scheme and the time required to be spent by the trustees or anyone acting on their behalf.



Timing: The first wave

— Schemes with £5 billion or more in assets on their first scheme year end date to fall on or after 1 June 2020 are subject to the climate governance requirements from 1 October 2021. These schemes must then publish a TCFD report by the earlier of:

- 7 months of the end of the scheme year which is underway on 1 October 2021; and
- 31 December 2022 unless audited accounts have not been obtained in respect of that scheme year, in which case they apply from the date they are obtained.

The second wave

— Schemes with £1 billion or more in assets will be subject to the requirements from one year after that scheme year end date and must publish their TCFD report by the earlier of:

- 7 months of the end of the scheme year which is underway on 1 October 2022; and
- 31 December 2023 unless audited accounts have not been obtained in respect of that scheme year, in which case they apply from the date they are obtained.

Horizon scanning

— TPR's recently published draft single code includes a section on climate change. TPR expects schemes with at least 100 members to have in place (and other schemes may wish to consider these as best practice) a risk management function as part of their effective system of governance in relation to climate risk. This should include:

- Considering the possible short, medium and long-term effects of climate change on the objectives of the scheme and its operations.
- Maintaining and documenting processes for identifying and assessing climate-related risks and opportunities.
- Integrating these processes into their risk management and governance arrangements.
- Ensuring the governing body oversees, assesses and manages climate-related risks and opportunities related to the scheme.

And in related news…

The DWP published a call for evidence on 24 March 2021 ([Consideration of social risks and opportunities by occupational pension schemes]) seeking views on the effectiveness of occupational pension scheme trustees' current policies and practices in relation to social factors. Trustees are required to have a policy on social factors they consider to be financially material. There is no suggestion that the government currently intends to change the current legal obligations in this area. Responses should be submitted by 16 June 2021.

Have you thought about…?

Dashboards – no longer just a concept

Pensions dashboards are intended to provide an online service which will allow people to see their pensions information from multiple arrangements all in one place. As a concept its attractiveness is its simplicity. It is an idea that has been borrowed from other countries and should be beneficial to anyone who has more than one pension arrangement.

Here is a summary of what we know so far, and what we expect to see coming down the line.

History

Pensions dashboards were originally suggested by the Financial Conduct Authority in 2016 to enable individuals to view all their pension arrangements in one place. With more people moving to DC pensions coupled with the fact that individuals increasingly no longer have a 'job for life' and can often build up pension benefits with multiple employers, the DWP recognise that there is a need to assist savers with accessing all of their pension arrangements and simplifying this process for them.

Following a budget announcement in 2016, the government established an industry-led pensions dashboard project group with a further consultation following in 2018 on how the pensions industry can create these dashboards online. The response to the consultation was issued in April 2019 and the government proposed that legislation would require pension schemes to make data available to savers through their chosen dashboard.

Of course, this means increased administration responsibilities for pension providers and trustees of occupational pension schemes alike, as the requirements underpinning the new dashboards will compel schemes to participate and provide the information they need to operate effectively. The industry was supportive of the proposal for schemes to participate in stages and the intention is to prioritise the largest schemes first who have the greatest number of members –large DC schemes and Master Trusts.

Who is going to oversee the implementation of the dashboards?

The pensions dashboard proposal recognises that the pensions industry is best placed to design and develop its own dashboards, but to assist with this the government has said that the Money and Pensions Service (MaPS) had agreed to create an industry delivery group in 2019 to deliver the dashboard project and create and run its own non-commercial pensions dashboard. MaPS has established its own Pensions Dashboards Programme (PDP), a delivery group responsible for putting the necessary infrastructure in place.

Compulsion

The route to compelling pension schemes to participate is to piggy-back on existing legislation. In effect, the dashboard will be providing savers with the information they could request via a GDPR subject access request to their pension provider, except that pensions dashboards will present it in a specific format online.

When is this expected to come into effect?

The PDP's planned timeline includes voluntary onboarding and testing from 2022, followed by staged compulsory onboarding and making the service available to savers from 2023.

The Pension Schemes Act 2021

The Pension Schemes Act 2021 lays out the framework for a publicly owned dashboard service, to be administered by MaPS. Under the Act, a qualifying pensions dashboard is described as "an electronic communications service by means of which information about pensions may be requested by and provided to "an individual or a person authorised by the individual". The government has said that no commercial dashboard should launch before MaPS dashboard is up and running.

A qualifying pensions dashboard service will need to meet prescribed requirements relating to:

- What information must be provided to individuals about their pension arrangements (including the state pension).
- How the pensions dashboard service will be established, maintained and operated.
- The provision of information, facilities or services by the dashboards.
- Dealing with requests for information about pensions, including the use of intermediaries and electronic communications.

Are any schemes exempt?

The consultation response noted that there is a case for exempting some very small schemes but further work is required to understand the impact.

What's next?

Whilst the Act was an important milestone, the government will now need to consult on draft regulations to compel occupational pension schemes to connect with the pensions dashboards and ensure legislation is in place to allow the FCA to make corresponding rules for personal pension plans.

In the meantime, MaPS is encouraging the pensions industry to get "dashboard ready" and prepare for the new legal duties in respect of the provision of information. MaPS published initial data standards in December 2020 which set out what information pension schemes and providers will receive from the dashboards and what they will have to provide in return. Trustees and scheme providers alike will need to keep an eye on the PDP's progress and its consultation with the pensions industry. MaPS also suggests that it is a good time to think about getting scheme data 'in shape' so that members are able to access their information as dashboards come on online.

And finally…

Small pots and expanding the Dormant Assets Scheme

The rise of small dormant unclaimed pension pots in the system – driven by the advent of auto-enrolment and an increasingly mobile workforce – is a persistent issue facing the industry.

Policymakers have been looking at ways to address it:

- **December 2020**: The DWP published a cross-sector working group report which looked at ways that member-initiated consolidation and technological initiatives, like pensions dashboards, could offer potential solutions.
- **January 2021**: The government announced proposals to include some insurance and retirement income assets within the "Dormant Assets Scheme" – an initiative set up with the aim of reuniting savers with lost assets. Where this isn't possible, the assets are used to fund "good causes" – from financing environmental enterprises to supporting programmes to encourage financial inclusion.

The Dormant Assets Scheme: How does it work?

The Dormant Assets Scheme is a voluntary scheme that, currently, only banks and building societies can opt into.

In essence:

- The balance of a "dormant" bank or building society account that has remained untouched for a minimum of 15 years (despite efforts to reunite it with its owner) can be transferred to a "Reclaim Fund".
- A portion of the money in the Reclaim Fund is used to fund social and environmental enterprises, with the rest retained in case the owner later comes forward to claim the monies that were formerly held in their account.

Since it began in 2008, funds from the Dormant Assets Scheme have been used to finance a range of initiatives across the UK – with a focus in England on youth, financial inclusion and social investment.

In 2020, £150 million of dormant assets funding was released to help charities, social enterprises and individuals in need of support during the COVID-19 outbreak.

What are the new proposals?

In the past the government has been reluctant to widen the scope of the Dormant Assets Scheme but is considering including certain pension products – e.g. annuities with a guaranteed payment period, income drawdown, deferred annuities and, potentially, contract-based DC pensions.

Why now?

From an economic perspective, the proposals make sense – particularly in the current environment. The government has indicated that dormant assets across the insurance and pensions, investment, wealth management and securities sectors could potentially make £800 million available to support the UK economy, in the aftermath of the COVID-19 pandemic.

How will this affect pension savers?

The government maintains that the main priority of the expanded scheme would still be to locate and reunite individuals with their financial assets – and that it would still have the principles of consumer protection at its core.

What are the issues?

Defining the scope:

— When a pensions product is classified as "dormant" will need to be carefully defined – as only assets that are genuinely "dormant" should be transferred to the Reclaim Fund.

— Contract-based pension products are long-term savings vehicles, which can run for a long time before they are expected to provide benefits. That means that it is not unusual for an owner to have little (if any) regular contact with the provider before the benefits start to be received.

So where do you draw the line?

— The government is currently proposing that only assets that are capable of crystallising into cash should be included. So, for example, a retirement income policy could potentially qualify as "dormant" if it is identified that the deceased owner has no next-of-kin.

— Certain pension products – such as policies held under group trusts, like occupational trust-based pension plans – don't naturally lend themselves to inclusion in the scheme and, for the time being, the government has indicated that they should be expressly excluded.

Supporting tracing:

— Another issue that will need to be thought through is how providers would be expected to carry out tracing activities.

— It's commonplace for savers to move home and not inform their pension provider – making communicating with them a challenge. Often, providers only become aware of a change of address if communications that they send to the owner are returned. And, when it comes to establishing whether the policyholder has died, providers need to rely on notifications from a third party (usually a family member or legally appointed representative).

— Efforts to trace lost customers in the contract-based personal pensions space currently vary between providers, and there's no agreed "best practice" or framework from the FCA.

— Providers would therefore inevitably need to take a more active approach to tracing and, whilst this would clearly benefit savers, there would need to be systems in place to support this – e.g. to support the sharing of data from HMRC.

What's next?

Although the government has indicated that it intends to legislate for scheme expansion when parliamentary time allows, the proposals are still in their early stages. So watch this space.

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