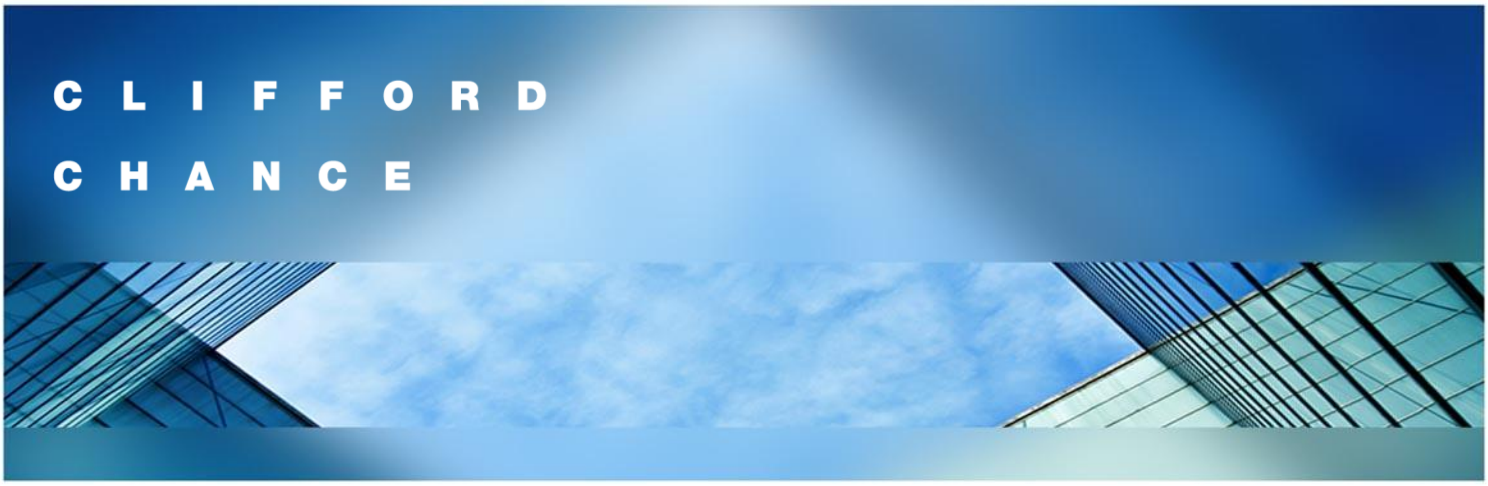

UK PENSIONS UPDATE – SEPTEMBER 2024

In this edition, we discuss the new government's upcoming pensions review and Pension Schemes Bill. We also consider the Financial Conduct Authority's value for money consultation, the final draft defined benefit funding Code of Practice which was laid before Parliament over the Summer, the Court of Appeal's decisions in *Virgin Media* and *BBC*, as well as the updated superfund guidance, updates on the Lifetime Allowance abolition and upcoming increase in normal minimum pension age and the Regulator's push for schemes to prepare for the dashboards regime.

Content

1. PENSIONS REVIEW TO COMMENCE IMMINENTLY

Following the General Election, the King's Speech in July promised a new Pension Schemes Bill, which is set to introduce a number of key measures, discussed below. This was swiftly followed by the Chancellor's announcement of a "pensions review" which will form part of the government's mission to boost growth.

The terms of reference for **phase one of the review** were published last month and confirm that this will focus on defined contribution (**DC**) schemes and the Local Government Pension Scheme (**LGPS**). Key to this will be looking at how to drive scale and consolidation of DC workplace schemes and encouraging further pension investment in UK assets to boost growth.

A call for evidence was published on 4 September 2024 inviting input from interested parties to inform the first phase of this investment review. This closes on 25 September 2024 and asks open questions around DC consolidation, the role of master trusts versus group personal pensions and the potential to increase investment in UK asset classes such as unlisted and listed equity and infrastructure. Alongside this, the call for evidence will engage extensively on next steps with regard to LGPS consolidation.

The **second phase** of the pension review is due to start later this year and, alongside investment, will consider further steps to improve pension outcomes, including assessing retirement adequacy. (Apart from the LGPS, the rest of the defined benefit (**DB**) market is out of scope of this review.)

Pension Schemes Bill

It is expected that this will include measures to:

- Prevent people from losing track of their pension pots through the consolidation of DC individual deferred small pots. This looks to be a follow on from the previous government's proposal to proceed with a multiple default consolidator model, whereby a small number of authorised schemes would act as consolidators for eligible deferred pension pots (deferred pension pots of £1,000 and below which have not received contributions for 12 months and which were created since the introduction of auto-enrolment within charged-capped default funds). (See the [December 2023 edition of the UK: Pensions Update] for more details.)

- Introduce a standardised Value for Money (**VFM**) test for trust-based DC schemes. (See further at item 2 below for discussion on the Financial Conduct Authority's (**FCA**) recently launched consultation.)
- Require trustees to offer a retirement income solution or range of solutions to their members. This could be a continuation of the Conservative government's consultation from last year on helping savers understand their pension choices at retirement, which proposed placing duties on occupational pension scheme trustees to offer decumulation services and products at an appropriate quality and price when savers access their pension assets, either themselves or through a partnership arrangement.
- Consolidating the DB market through commercial superfunds.
- Reaffirming the Pensions Ombudsman as a competent court (removing the need for schemes to apply to the courts to enforce an Ombudsman decision in relation to the recovery of overpayments – see the December 2023 edition of the UK: Pensions Update for more details).
- Amending the Special Rules for End of Life under the Pension Protection Fund (**PPF**) and Financial Assistance Scheme (extending the definition of "terminal illness", allowing eligible members to receive a lump sum payment at an earlier stage).

2. FCA LAUNCHES CONSULTATION ON VFM FRAMEWORK

On 8 August 2024, the FCA published a consultation paper, setting out proposed rules and guidance for a new VFM framework for contract-based workplace DC schemes.

While the FCA consultation is focused on contract-based schemes, the government intends to legislate (via the new Pension Schemes Bill) so that the framework may also be applied to trust-based schemes regulated by the Pensions Regulator (**TPR**). The idea is to introduce a standardised VFM test.

Under the FCA's consultation, the proposed framework would introduce four key elements, designed to:

- require the consistent measurement and public disclosure of investment performance, costs and service quality by firms for all such arrangements against particular metrics;
- enable those overseeing and challenging an arrangement's value – Independent Governance Committees (**IGCs**) and Governance Advisory Arrangements for contract-based schemes – to assess performance against other arrangements and require them to do so on a consistent and objective basis;
- require public disclosure of assessment outcomes including a 'red, amber, green' VFM rating for each arrangement; and
- require firms to take specified actions where an arrangement has been assessed as not VFM (red or amber).

The framework is intended to fit within existing Consumer Duty processes firms will have put in place. (Under existing rules, firms have an obligation under the Consumer Duty to consider the value of the pension products they offer. For workplace pension products, they must use their IGG's conclusions in their assessment.)

The consultation closes on 17 October 2024. The FCA will consider responses jointly with the Department for Work and Pensions (**DWP**) and TPR.

In a blog published on 29 August, TPR has also called on trust-based schemes to help shape the framework. TPR says it particularly wants to hear views on how best to measure quality of service.

3. DB FUNDING CODE LAID BEFORE PARLIAMENT

TPR's final draft DB Funding Code of Practice was laid before Parliament on 18 July 2024 and is expected to come into force in early November. Alongside the final Code, TPR also published its response to the consultation on the Code and response to the Fast-Track consultation.

Key points to note include:

- While there will be a slight gap between when the new statutory requirements apply (for schemes with valuation dates from 22 September 2024) and the final Code coming into force, TPR is not expecting this to cause a significant issue given the Code is not a statement of law. The sense from the consultation response is that the Code is unlikely to change as a result of the parliamentary process and, if it did, TPR would take this into account when assessing valuations.
- The final draft makes clear that the regime is not imposing any restrictions on the investments trustees actually make. It now makes a distinction between "actual" and "notional" investment allocations with the low dependency investment allocation (**LDIA**) being a notional investment allocation used to derive and support actuarial assumptions for funding purposes. The Code says that TPR expects, for most schemes, investing in the best interests of members at and after the relevant date (such date to be set by the trustees, and being no later than the end of the scheme year where the scheme is expected to reach significant maturity) will mean investing in line with the LDIA, but recognises this will not be the case for all schemes.
- The final Code defines significant maturity (the latest date by which the scheme is expected to be fully funded on the low dependency funding basis) as the date on which a DB scheme reaches a duration of liabilities of 10 years. For cash balance schemes, this is 8 years. This is a change from the 12-year period included in the draft and reflects a shift in market conditions as TPR now expects (in line with the final regulations) the economic assumptions at each valuation to be set based on the economic conditions that applied as at 31 March 2023 (rather than 31 March 2021), as if that were the valuation date.
- The final Code includes some more detail regarding the requirement that to meet the low dependency test no further employer contributions are expected to be required and confirms this does not mean the need for further employer contributions should be eliminated, but that trustees need to be satisfied the likelihood of requiring further contributions is small (and to the extent they are required, they are small relative to the size of the scheme).
- The definition of schemes eligible to use a simplified process for certain elements of the fast-track route has changed from schemes with fewer than 100 members to schemes with 200 or fewer members at the valuation date. In counting members for this purpose, the following are excluded: (i) members eligible for lump sum death benefits only; (ii) DC only members; and (iii) fully insured annuitants where they are not included in the calculation of Technical Provisions.
- TPR continues to consider that trustees should follow the overriding principle that steps must be taken to recover deficits as soon as the employer can reasonably afford (although the Code does also say that trustees must also take certain matters into account, including the impact of the recovery plan on the sustainable growth of the employer). TPR acknowledges that some respondents raised concerns this approach could lead to a trapped surplus and that while the final regulations and final Code do not deal with this explicitly, the "*DWP has signalled this will be considered as part of its ongoing consultation on surplus management*."

A number of further updates are still expected:

- TPR expects to publish the final statement of strategy and consultation response in the Autumn.
- TPR will also publish a document setting out its approach to regulating DB schemes in due course, including more detail on the twin track approach and the regulatory filters it will use when assessing valuations.
- TPR will publish a consultation on updated covenant guidance in due course, focusing on the main areas that trustees must consider when assessing employer covenant under the Code. TPR will also provide guidance on maximum affordable contributions and affordability for recovery plan purposes.
- TPR will also review the existing DB funding and investment-related guidance (no timeframe has been given for this yet).

4. COURT OF APPEAL DISMISSES APPEAL IN *VIRGIN MEDIA*

The Court of Appeal has handed down its judgment in *Virgin Media*[1], dismissing the employer's appeal.

The High Court had previously held[2] that pension schemes which had made amendments to section 9(2B) rights (contracted-out rights accrued between April 1997 and April 2016) without the actuarial confirmation required by the legislation were void. The judge also confirmed that this applied to amendments to both accrued rights and those rights attributable to future service. (See the June 2023 edition of the UK: Pensions Update for more information.)

The appeal specifically challenged the High Court's finding that section 9(2B) rights for this purpose covered both rights before and after the date of the amendment, arguing that it should only encompass past service rights. However, the Court of Appeal unanimously dismissed the appeal, ruling that the requirement for an actuarial confirmation applied to both past and future service 9(2B) rights. Note that from 6 April 2013, the legislation was amended to only apply to future service 9(2B) rights; it was the legislation in place between 6 April 1997 and 5 April 2013 that was being considered here.

It is not expected that there will be an appeal to the Supreme Court. This case could impact many schemes which were previously contracted-out on a salary-related basis. In the meantime, a joint pensions working group issued a statement confirming that it has been working with the DWP to propose that the Secretary of State should make regulations to retrospectively validate any amendment that is held to be void solely because a written actuarial confirmation was not received before the amendment was made. It has been reported that the DWP is considering any wider effects for schemes/members as it explores the implications of the judgment, but no indication has been given yet as to whether such regulations will be made.

It should be noted that how the parties concluded that there was no required actuarial confirmation in this particular case is not explored in the judgments. The Court of Appeal did helpfully confirm, *obiter* that "*it was not necessary for there to be a formal certificate appended to the deed – all that was required was written confirmation*" (but in the *Virgin Media* case no such written confirmation had been found).

5. COURT OF APPEAL HANDS DOWN JUDGMENT IN *BBC*

Over the Summer, the Court of Appeal also handed down its judgment in the *BBC*[3] case.

The High Court case[4] related to a Part 8 Claim brought by the BBC in the context of proposed changes to future accrual within the BBC Pension Scheme with a view to reducing ongoing costs. The amendment power was subject to certain fetters, including that no alteration or modification shall take effect as regards active members "*whose interests are certified by the Actuary to be affected thereby*" unless certain criteria are fulfilled (which, broadly, were designed to ensure that the relevant "interests" are not substantially prejudiced). (See the September 2023 edition of the UK: Pensions Update for more details.)

The BBC appealed the High Court's decision – specifically, the finding that active members' "interests" in the amendment power proviso meant members' interests in both past and future service benefits (including final salary linkage). The BBC argued that this should only protect past service benefits and therefore the amendment power protection would not be engaged if the proposed amendment only related to future service benefits (e.g. to change the rate of future accrual and/or to break the final salary link).

The Court of Appeal unanimously dismissed the appeal, upholding the High Court's original finding that "interests" of active members covered past service rights, final salary linkage on past service rights, the ability to accrue future service benefits under the scheme on the same terms as immediately before the amendment and the ability of members to accrue any future service benefits under the scheme.

The ruling emphasised that while there have been many cases in the past considering the wording of specific pension scheme amendment powers, "*ultimately, the meaning of a particular clause turns on its own interpretation*". The starting point (and often the end point) is the natural meaning of the phrase seen in its context. Ultimately the court concluded that "interests" is a deliberately simple, broad and open-textured word and unlike other examples of

1 *Virgin Media Ltd v NTL Pension Trustees II Ltd [2024] EWCA Civ 843.*
2 *Virgin Media Ltd v NTL Pension Trustees II Ltd and others [2023] EWHC 1441 (Ch).*
3 *BBC v BBC Pension Trust Ltd [2024] EWCA Civ 767.*
4 *BBC v BBC Pension Trust Ltd [2023] EWHC 1965 (Ch).*

amendment power fetters, it is not tied to "rights"; still less to rights that have "accrued" or been "secured". Nor is it limited by reference to any particular cut-off date.

6. TPR PUBLISHES UPDATED GUIDANCE FOR SUPERFUNDS

TPR has published updated versions of its superfunds guidance and accompanying superfund guidance for transferring trustees/employers. This follows a review of the guidance and engagement with stakeholders in November 2023 and February 2024.

The guidance has mainly been updated to provide further detail on capital/profit release, residual risks, the practical application of some of the investment principles, capital-backed arrangements and considerations for schemes with an insolvent employer in PPF assessment.

There is yet to be a formal update on when the industry can expect a permanent legislative regime to be introduced.

Key features of the updated guidance

Capital extraction	The previous guidance only allowed capital to be released when benefits were bought out and said that TPR planned to develop a specific mechanism based on a profit trigger to enable capital extraction. The guidance has now been updated to confirm that it is possible to extract profits from a superfund before buy-out where the superfund assets exceed the minimum capital buffer by a margin of at least 33%. To avoid capital being released due to short-term market movements and to avoid superfunds cherry-picking favourable dates, the updated guidance says that superfunds have to nominate capital release calculation dates at the outset (being one date each year or two dates each year, separated by six months), look back from those dates over the preceding month-ends and take an average for the prior six months. If the trigger is met on the capital release calculation date, and for the average of the preceding six months, surplus capital may be released (giving superfunds effectively two pre-determined opportunities a year to extract profit).
Expectations on residual risks	The guidance has not been materially amended, but TPR's position has been clarified in relation to the due diligence trustees are expected to undertake when considering transferring to a superfund.
Investment principles	A number of clarifications have been made regarding the investment principles, specifically principles 3 and 6 which relate to limits on the recognisable maximum allocations of any issuance of a security and investments in transferring employer investments or asset-backed funding respectively.
Relaxation of capital adequacy requirements following employer insolvency	In the interests of opening up the superfund market to help schemes whose employer has become insolvent and are unable to buy-out full benefits, TPR says that entry into a superfund may be appropriate even if the provider is unable initially to meet the capital adequacy requirements. Trustees would need to satisfy themselves that they have a robust rationale for entering into the arrangement, and be able to evidence that the transaction on lower capital adequacy terms would be in members' interests and that there is a high level of certainty that members will not end up with lower benefits than with an immediate PPF+ buy-out. The updated guidance sets out some expectations in this scenario. TPR also says it expects some capital-backed arrangements that do not involve a transfer to a superfund to comply with the superfund guidance in certain circumstances – namely, where the original employer is substituted with an a special purpose vehicle (**SPV**) and separated from the original solvent employer or an SPV employer is

introduced to enable the scheme to run on after an insolvency event has occurred (but not where the employer remains in place and its obligations in respect of the scheme are unaltered – TPR views these as investment products).

7. HMRC CONSULTS ON FURTHER TECHNICAL CHANGES FOLLOWING ABOLITION OF LIFETIME ALLOWANCE

As discussed in the June 2024 edition of the UK: Pensions Update, the industry has been awaiting further regulations intended to address a number of minor technical changes flowing from the abolition of the Lifetime Allowance.

Specifically, HMRC's pension schemes newsletter 158 (published on 4 April 2024) flagged that schemes should ensure members are aware of the need for further legislative changes and some members may need to wait until these are effective before taking or transferring certain benefits. This will mean that a member's available allowances and tax position do not need to be revisited later in the year. The main instances for delay in proceeding include:

- Members with enhanced protection may wish to delay transferring to a new provider until the new legislation reflects the intention to allow members to carry over the benefit of enhanced protection.
- Members with primary or enhanced protection and protected lump sum rights may choose to either limit the amount of the pension commencement lump sum (**PCLS**) they decide to take or delay the payment of their PCLS in order that they can take their full entitlement, over the current lump sum allowance of £375,000.
- Personal representatives may wish to delay requesting the payment of a lump sum death benefit where the payment would be made from funds which crystallised prior to 6 April 2024 until the permitted maximum restriction is removed on such payments.
- Members may wish to request a delay to the payment of a PCLS under scheme-specific lump sum protection until changes are made to correct an unintended "double counting" in the current legislation.

HMRC's pension schemes newsletter 161 (published on 7 August 2024) gives an update on this, saying that the government plans to introduce the necessary regulations as soon as the parliamentary timetable permits after the summer recess. This will follow a short technical consultation on the draft legislation (which closed on 14 August 2024).

8. NEW GUIDANCE ON PREPARING FOR NORMAL MINIMUM PENSION AGE CHANGE

In August, the Pensions Administration Standards Association (**PASA**) published some new guidance (published on 12 August 2024) which is intended to assist pension schemes in preparing for the increase in normal minimum pension age to age 57 from 6 April 2028. (See the January 2022 edition of the UK: Pensions Update for more background information.)

The guidance considers how to deal with members who may have a protected pension age, what to do when members with a protected pension age have been or are to be transferred and how to conduct communication exercises with members affected by the change. The guidance also provides a checklist of actions which should be taken now to prepare for any new legislation.

Although 2028 is some way off, trustees and scheme administrators should be considering what action they may need to take early on.

PASA comments that further transitional regulations from the government to address minor consistencies are also expected.

9. TPR URGES SCHEMES TO PREPARE FOR DASHBOARDS

On 5 September, TPR published a blog urging schemes to get ready for the dashboards regime. This follows publication of TPR's final pensions dashboards compliance and enforcement policy.

As a reminder, the DWP's guidance published earlier this year set out a staging timetable for pension schemes to connect to the pensions dashboards ecosystem and be in a position to process "Find" and "View" requests.

The ultimate mandatory deadline of 31 October 2026 remains the same. However, a staging timeline based on the type of scheme and the number of members (with the largest master trusts and FCA-regulated operators of personal pension schemes being the first to connect) is set out which runs from 30 April 2025 to 30 September 2026.

While the staging timetable is not mandatory, trustees of occupational pension schemes are required by pensions legislation to "*have regard to guidance on connection issued from time to time by the SOS, MAPS and the Regulator*" and personal pension schemes are subject to equivalent requirements.

In the latest blog, TPR says that many schemes are preparing correctly, but some are not measuring or improving their data adequately. The blog urges trustees to read TPR's new guidance and the DWP's connection guidance and plan to connect in a staged and orderly manner in line with DWP guidance.

TPR says that ensuring data is robust and accurate is absolutely essential. Specifically, schemes should look to:

- Manage risk: Identify, evaluate, and record risks, and put controls in place.
- Review and adjust: Trustees need to continuously review and improve controls that are in place, adjusting where needed.
- Keep robust records: Trustees need clear records (of decisions made and advice received) and to receive regular reports.
- Report and mitigate breaches promptly: Trustees must have processes in place to identify breaches and report them to TPR as necessary.

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