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Legal Update

June 2023

UK Pensions Update: Where are we at the 2023 halfway point?

In brief

In our "What do I need to know for 2023" update earlier this year, we highlighted the key areas for trustees and employers to keep an eye on over the coming year. With delays to implementing key policies such as the DB Funding Code and dashboards having been announced, as well as new legislation and guidance coming out, we take a look at where we are midway through the year.

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Buy-out/buy-in and alternative endgame options

As expected, the first half of the year has been a busy one for buy-outs/buy-ins.

As funding levels in many schemes continue to improve potential or actual surpluses have started to arise. Interestingly, the Pensions Regulator's recent 2023 Annual Funding statement recognised that trustees of schemes where funding levels are at (or above) buy-out level may decide that running a scheme on is a better option for members on the basis that it offers members the prospect of benefitting from future surpluses. Running on a scheme may also be an arrangement which employers prefer if it offers the ability to use a potential surplus for future DC accrual.

The Regulator's 2023 annual funding statement can be found here.

New DB funding regime delayed

Changes to the funding regime for DB occupational schemes, which had been expected to come into force in October, have been delayed. The timescales have shifted for several reasons, including recent economic market volatility and the need to wait for the findings of the House of Commons' Work and Pensions Committee Call for Evidence on DB pensions - see more below.

The Regulator has said in its corporate plan that it is now expecting to launch the new DB funding code in April 2024. Before the new regime can come into force, the final legislation for the new regime is needed. Draft regulations were consulted on in July 2022, but we are still awaiting a response to the consultation and the final regulations.

General Code

Changes to the funding regime for DB occupational schemes, which had been expected to come into force in October, have been delayed. The timescales have shifted for several reasons, including recent economic market volatility and the need to wait for the findings of the House of Commons' Work and Pensions Committee Call for Evidence on DB pensions - see more below.

At the time of writing, we still do not have the final version of the Regulator's "General Code of Practice" (formerly known as the "Single Code"). This has to be laid in Parliament for 40 days before it comes into effect, and it now looks unlikely that this will happen before the Summer parliamentary recess. We will update you once the final version is published. Some trustees will have a lot to do to ensure their scheme complies with the new requirements, although the Regulator has already indicated that it will be pragmatic about enforcement as schemes get to grips with the new Code.

Pension dashboard: update on connection timings

At the beginning of March, the Government announced that the staging timetable for the largest pension schemes to connect to the dashboard was to be pushed back, owing to the fact that the Pensions Dashboards Programme needed additional time to deliver the technology necessary for schemes to connect to the dashboard. However, it was clear from the Government's statement that it remained committed to implementing the new regime in its current form.

On 8 June, the Pensions Minister announced that new regulations were being laid setting out one mandatory connection deadline of 31 October 2026, with earlier staging dates for different types and sizes of scheme being set out in separate guidance to be issued by the DWP and MaPS. The Government's statement can be found here. These earlier staging deadlines have not yet been confirmed and it is not yet clear what their exact legal status will be; the Government has said that it will work collaboratively with the industry "this year" in connection with the new guidance. The Pensions Minister commented that this new approach would give the Pensions Dashboards Programme "the flexibility it needs to ensure this complex project is completed effectively". The Regulator has updated its initial dashboards guidance following the announcement about the timings, in which it confirmed that trustees "must have regard to the guidance" once published.

Trustees should continue to work closely with their administrators to agree their route to connection, including to decide whether a third-party Integrated Service Provider (ISP) will be required, and to review data and agree an appropriate data matching policy.

Transfers

The dust has not yet settled following the introduction of the new 2021 transfer conditions regulations and the practical difficulties that they have thrown up for trustees. Trustees have particularly struggled with operating the "red flag" of offering members incentives to transfer and the "amber flag" relating to situations where the receiving schemes have overseas investments. We are aware that various industry bodies are in discussions with the DWP to see if the regulations can be amended to clarify the position with regard to these particularly tricky areas, and we'll provide a further update when we know more.

In addition, we've also had the publication of the long-awaited PSIG anti-scam guidance, published in the form of an interim "Practitioners Guide" on 20 March. The full Code itself will be amended once the Regulations are clarified or amended. Drawing out some key points from the new Guide:

- The Guide addresses the current uncertainties under the transfer regs, focusing on the two "flags" referred to above.
- It provides a helpful summary of a recommended due diligence process following a transfer request, including communication requirements. It covers both the statutory regime and also discretionary, or rules-based, transfers.
- PSIG comments quite extensively in the Guide on the use of "clean lists", which are lists of pension arrangements that a trustee (or, more likely in practice, an administrator) has identified that are not likely to be scam arrangements. The Guide notes that there is a clear risk attached to using clean lists, as almost all pension arrangements are likely to include some overseas investments and so could present an amber flag that would require specific action and would undermine the whole concept of a clean list. The Guide is therefore clear that, where a clean list is to be used, it is extremely important that the list is very carefully compiled and maintained. The Guide also contains a chapter on the risks of trustees *not* using a clean list, which include complaints from members about delays and unnecessary referrals to the MaPS Moneyhelper service. The Guide acknowledges this tension and notes that trustees will need to balance carefully the risks of using, and not using, clean lists.

Hopefully, we'll have an update on this topic soon.

PSIG's Interim Practitioners Guide and short summary can be found here.

Equality, diversity and inclusion

Following publication of its action plan in Autumn last year, the Regulator recently published detailed guidance for trustees and trustee directors on steps they can consider taking to promote equality, diversity and inclusion on the trustee board. The Regulator believes that EDI supports robust discussion and effective decision-making and, as such, complements the Regulator's wider focus on governance. It includes guidance on the points trustees may wish to include in an EDI policy and how the Chair can encourage EDI.

In recognition of the fact that employers will often have the power to appoint trustees, the Regulator has also published separate guidance for employers on the benefits of promoting EDI on trustee boards and how they can go about doing this.

This is a topic which trustees and employers are increasingly engaging with. The new guidance will be an additional element for trustees and employers to take into account as they continue to do this. We have been helping some trustee boards develop their own bespoke EDI policies and we are increasingly seeing this as a helpful way of setting and monitoring objectives in this area.

The Regulator's guidance can be found here.

DC developments

The first half of the year saw various legislative developments impacting DC schemes come into force and a steady stream of calls for evidence and consultations. With several policy areas still at a relatively early stage, and DC continuing to be a key priority area for both the Government and the Regulator, DC continues to be an area to watch in the second half of the year.

- **New "disclose and explain" requirements relating to illiquid assets are now in force**. Trustees will be required to make disclosures about their illiquid asset policy as part of their default SIP the first time this is revised after 1 October 2023 and by the latest by 1 October 2024. Asset allocation disclosures for default arrangements will be required in the Chair's statement for the first scheme year which ends after 1 October 2023. In addition, a new optional facility for certain "specified performance fees" to be excluded from the charge cap is also available from 6 April 2023. If trustees are making use of this facility, trustees will be required to make additional disclosures as part of the Chair's statement for the first scheme year which ends after 6 April 2023. You can find further detail on the changes here.

- **Ongoing market volatility and the rising cost of living continue to give rise to issues**. At the start of the year the Regulator issued a guidance statement setting out its expectations of what trustees of DC schemes should address across various areas including investments, communications and supporting members with decision making. The points from the guidance have recently been reiterated in a blogpost. The Regulator's statement can be found here and the blogpost here.

- **Keep an eye on developments on the value for money framework:** the Government and the Regulator are keen to see increased levels of standardised disclosure across both occupational and contract-based schemes allowing easier comparison between different arrangements. Ultimately, the expectation is that this will drive further consolidation in the DC market. A joint consultation by the Regulator, the FCA and the DWP was published earlier in the year. This is still at a fairly early stage but is one for DC trustees to have on their radar.

- **Small pots** - trustees should also be aware of future developments to address the tricky issue of deferred members and small pots. Earlier in the year the Government issued a call for evidence exploring potential options to deal with these issues, and so we expect to see further development on this in due course.

Extension to the auto-enrolment regime

Legislation changing the automatic enrolment regime is currently progressing through Parliament. It has been introduced as a Private Members Bill but has the Government's support.

The changes would allow the Government to issue regulations to implement two changes proposed as part of its 2017 review of automatic enrolment. Firstly, to reduce the lower age limit at which workers must be automatically enrolled into a pension scheme by their employers to age 18 (the limit is currently 22). Secondly, to reduce or repeal the Lower Earnings Limit of the qualifying earnings band so that contributions are calculated from the first pound earned.

The Government has indicated that if the Bill receives royal assent, there will be a further consultation in the Autumn before any changes are implemented. The timing of when any changes would come into force is not currently clear.

In a separate automatic enrolment development, the DWP has published a call for evidence looking at how the alternative quality requirements for DB and hybrid schemes which are being used for automatic enrolment are working. The alternative quality requirements allowed for different (simpler) tests so that they could be used for automatic enrolment purposes.

LDI developments

Following the publication of our alert relating to the regulatory reaction to the liability-driven investment (LDI) crisis of November 2022, the Regulator published new guidance for the industry on the use of LDI products in April. The FCA also published guidance for LDI managers on enhancing resilience in LDI on the same day.

Both sets of guidance followed a Bank of England statement in March that recommended that LDI funds increase their resilience to interest rate shocks "substantially". The Regulator's guidance followed up on these recommendations and set out practical steps that trustees can take to manage risks when using leveraged LDI. The Regulator urges trustees to work closely with their investment consultants, LDI managers and other advisers when implementing its recommendations.

The Regulator's guidance is detailed and specific in terms of the actions the Regulator expects of trustees in this area. The guidance covers the following issues:

- where LDI fits within the scheme's investment strategy;
- setting, operating and maintaining a collateral buffer;
- testing for resilience;
- making sure the correct governance procedures are in place to implement and monitor LDI; and
- monitoring LDI arrangements.

One key recommendation from the Regulator relates to the establishment and maintenance of a collateral buffer. The buffer is formed of two elements: (1) an "operational buffer", which ensures sufficient liquidity to manage day-to-day volatility in the market; and (2) a "market stress buffer", which provides additional liquidity to enable resilience during severe market stress. These elements are cumulative. The Regulator sets out various considerations for trustees when setting their operational buffer, including taking account of volatility in the gilt market; it states that this buffer should at least reflect gilt yield volatility in normal market conditions. As for the market stress buffer, the Regulator notes that this should be, at a minimum, set at 250 basis points (assuming that the trustees are able to provide additional cash or assets to replenish the buffer within five days). The Regulator also provides guidance on how to maintain the collateral buffer, noting in particular that trustees may want to specify which assets can be sold for raising cash in pre-agreed instructions.

The Work and Pensions Committee call for evidence on defined benefit pension schemes

In March, the House of Commons' Work and Pensions Committee (the WPC) launched a Call for Evidence on DB pension schemes. The WPC asked various questions of the industry, noting the "critical importance" of DB pension schemes. The nine questions posed were wide-ranging, covering ground from what the Regulator could do to improve the quality of trustee boards to mandatory consolidation to the treatment of scheme funding surpluses to the future of the PPF. The Call for Evidence closed on 26 April and many key industry bodies responded to the WPC. There is no date yet fixed for the WPC to either publish or respond to the submissions made to it, but the results may well inform shifting pension policy in the longer-term, particularly if there is any change of Government in 2024/2025.

The 2023 Spring Budget Statement: what next?

We have reported previously on the key changes announced in March in the Spring Budget and we also covered this in detail at our April webinar. Since then, we have seen the draft legislation that will implement the changes already announced (most notably the removal of the lifetime allowance charge (LTA) and the increase in the annual allowance from £40,000 to £60,000). However, we have not yet seen any detail of how the Government will legislate for the complete removal of the lifetime allowance from April 2024. This means it is not yet clear how exactly the Government will remove the LTA from law whilst also retaining its effect in areas such as setting a maximum pensions commencement lump sum limit for earners with Fixed Protection or Enhanced Protection.

EU Retained Law Bill

Having previously mentioned the Retained EU Law (Revocation and Reform) Bill at our April seminar, we wanted to provide a recent update on the progress of this new piece of legislation. In mid-May, the Government announced a significant scaling down of the scope of the new legislation, with the result that no EU-derived pensions legislation will now automatically be "sunsetted" at the end of this year.

By way of background, the Bill was first introduced by Jacob Rees-Mogg in September 2022 when he was the Business Secretary. It was originally designed to automatically disapply a whole raft of UK laws that derive from EU Law (including a large amount of pensions law) at the end of this year. However, following extensive criticism and concerns about the breadth and possible unintended consequences of this Bill, the Government altered its position so that it is now only disapplying around 800 laws (the majority of which are now out of date in any event).

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Notifiable events

It remains unclear if the long-anticipated extension to the notifiable events framework, which had originally been expected to come into force in April 2022, will materialise in the second half of this year. Based on draft regulations which the Government consulted on in September 2021, the changes would require a wider range of corporate transactions to be reported to the Regulator and pension scheme trustees, at an earlier stage, than is currently the case. Further detail about the consultation proposals can be found here.

The Government recently confirmed in a response to the Work and Pensions Select Committee LDI inquiry that it is currently working with the Regulator to consider how to best to gather information about corporate transactions, including via changes to the notifiable events regime. The Government did not. however, provide any indication of when it will respond to the 2021 consultation as part of that statement.

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