CLIFFORD CHANCE

UK PENSIONS UPDATE – JUNE 2023

1. HIGH COURT RULING ON VALIDITY OF PENSION AMENDMENTS RAISES FRESH UNCERTAINTY

In a landmark ruling, the High Court has handed down judgment in *Virgin Media Ltd v NTL Pension Trustees II Ltd and others [2023] EWHC 1441 (Ch)*; a case which concerned longstanding questions about the adherence to procedural requirements and whether this was necessary for valid amendments to formerly contracted-out schemes.

In short, the judge concluded that amendments to contracted-out rights which had been made without the actuarial confirmation required by pensions legislation were void (and this was the case for any amendments affecting relevant benefits, not just adverse ones). The judge also confirmed that section 37 of the Pension Schemes Act 1993 (which provides that the rules of a contracted-out scheme "cannot be altered" other than in specified circumstances) protected both rights prior to the date of the amendment and rights attributable to future service. While the employer argued that making an amendment without the actuarial confirmation only made the amendment **voidable** and not automatically void, the judge disagreed, deciding that section 37 did render invalid and void an amendment to the rules of a contracted-out scheme which related to post-5 April 1997 contracted-out rights if made without the required actuarial confirmation. This was on the basis that there was no ambiguity in the wording of the regulations – its meaning was plain and unambiguous.

It is not yet known whether there will be an appeal. The finding could impact many schemes which were previously contracted-out on a salary-related basis if amendments have historically been made without the requisite actuarial confirmation. However, reaching a conclusion may not be straightforward in practice – for example, failure to produce a copy of the confirmation may not be sufficient evidence that no confirmation was provided.

2. REPORT PUBLISHED ON IMPACT OF PENSION TRANSFER REGULATIONS

The Department for Work and Pensions ("**DWP**") has published a report following its review of *the Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021*. The regulations came into force in November 2021 and imposed new conditions which must be met in order for a statutory transfer to proceed. Significantly, the regulations imposed additional conditions on statutory transfer requests, meaning that a transfer can only be made if trustees conclude that one of two conditions is satisfied: (i) the transfer is to a public service scheme, authorised master trust or authorised CDC scheme; or (ii) no red flags are present or, if an amber flag is present, the

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member has taken pension scams guidance. At that time, the DWP committed to conducting a review within 18 months to ensure the regulations are working effectively and are giving the maximum protection for pension savers. This report sets out the DWP's findings. In summary, the DWP has said that, overall, the feedback has been that there are some areas of concern. In particular, the amber flag where trustees decide there are any overseas investments included in the receiving scheme needs to be more clearly defined or removed and the red flag where trustees decide the member has been offered an incentive to make the transfer is incorrectly blocking transfers due to different interpretations being taken by providers. The DWP will therefore conduct further work to see if changes can be made to the regulations to improve the pension transfer experience.

3. TPR PUBLISHES CORPORATE PLAN

At the end of April, the Pensions Regulator ("**tPR**") published its corporate plan for 2023/2024, setting out its priorities for the upcoming year and providing a look beyond. This gives some useful insight into what we can expect to see over the coming months. In particular:

- **TPR's single Code of Practice**: TPR says it will **launch its general code** (previously, the single code) **this year**. It sounds like it will follow the format of the draft previously consulted on back in March 2021 as the corporate plan refers to the new code bringing together ten of tPR's existing codes into one source and indicates that it will follow a topic-based modular format. However, it is expected that the final code will have moved on somewhat given the draft was originally published for consultation over two years ago. TPR notes that a well-run scheme is not likely to see any major impacts resulting from the new code, but all schemes should be clear about the standards they are expected to meet. (Please see our UK Pensions Update: March 2021 for more details of the earlier consultation).

- **Defined benefit ("DB") funding code**: TPR appears to confirm that the original October 2023 timing for publication of the final version of the DB funding code (discussed in our UK Pensions Update: March 2023) has been pushed back, stating that it is getting ready to **launch a new DB funding code and regulatory framework in April 2024**.

- **Liability-driven investments ("LDI") and investment risk:** TPR refers back to its previous statements on LDI and managing investment risk (as discussed in our UK Pensions Update: December 2022) and says that monitoring market risks remains a priority. TPR is considering what further data would enable greater oversight of schemes' leveraged positions, and the best way of collecting that data. This may mean tPR seeks to increase the amount of information it gathers on a range of asset allocations, including LDI, but it will assess costs versus burden as part of any request it makes of schemes for more data. On the same day, both tPR and the Financial Conduct Authority ("**FCA**") published guidance on LDI (discussed further below).

- **Value for money framework:** TPR refers to development of the value for money framework, designed to increase transparency and competition in the market. The framework will require schemes to disclose clear and comparable metrics on their investment performance, costs and charges, and quality of services. **A response to the consultation** (please see our UK Pensions Update: January 2022 for more details) **is due in the summer**, and work will then begin on detailed policy development and implementation. This is likely to require legislative change.

- **Climate change**: TPR refers to a new code of practice which will include climate change and stewardship and will confirm its expectations of trustees in these areas. This appears to be a reference to the new general code and will inform the **DWP's planned review of regulations underpinning climate-related and stewardship disclosures, later in 2023.**

- **Trusteeship**: TPR notes that where it comes across instances of poor practice, it will ensure standards in scheme governance through **increased enforcement action**. This may include expanding the circumstances where some of tPR's powers, such as trustee appointments and prohibitions, may be used, as well as testing some of the new powers it has under the Pension Schemes Act 2021. TPR also intends to consider whether there should be a professional trustee on each trustee board, whether professional trustees should be accredited/there should be an authorisation process established for professional trustees.

- TPR says it will review its June 2020 superfunds guidance to ensure it continues to deliver what the market needs. Whilst it will continue to supervise the superfund that passed tPR's assessment in November 2021, tPR notes that

the standards in the guidance remain applicable for any potential superfund seeking to enter the market. TPR **intends to publish guidance on other DB models during the year**.

4. TPR PUBLISHES ANNUAL FUNDING STATEMENT

TPR has published its 2023 annual funding statement which is particularly relevant to DB schemes with valuation dates between 22 September 2022 and 21 September 2023.

TPR says most schemes have improved funding levels and trustees need to consider if long-term targets remain appropriate, whether buy-out is viable, or to examine other endgame options. TPR acknowledges that some schemes will also be facing calls from employers for reductions or suspensions to contributions, as well as from members for discretionary increases, given that pension increases may not have kept pace with inflation. When considering such pressures, tPR says trustees should be mindful of their overall position, the resilience of their investment strategy to future financial market movements and the level of covenant support.

Guidance depends on the scheme's funding level:

Where funding level is at or above buy-out	• Consider whether proceeding with a buy-out is the best way to lock in funding gains. If so, make sure scheme is in best position to approach the market e.g. investments in assets preferred by insurance companies. • Capacity issues in insurance market could mean a buy-out is not viable in the short term. May then consider a stepped approach involving a partial buy-out or buy-in. • May consider running on the scheme is a better option for members if it offers potential to benefit from future surpluses. However, this involves risk. Potential mitigation against this risk may be to create a specific risk buffer using some of the surplus.
Where funding level is above TPs but below buy-out	• It would be good practice to consider the steps that can be taken to align with the key principles of the draft funding code. • If well on the way to reaching buy-out funding level, consider getting 'insurance ready' as per the above. • If trustees have not agreed a long-term funding target ("**LTFT**"), they should do so as a priority. The direction of travel in the draft code should help to decide on an appropriate LTFT and a method for reaching it, including the broad timescale and the pace of de-risking.
Where funding level is below TPs	• Focus should be on bridging the Technical Provisions deficit first. • Risk-taking should be supported by the employer covenant and should reduce as the scheme gets better funded or matures. Any deficit should be recovered as soon as the employer can reasonably afford.

As in previous years, the statement then contains a number of tables setting out what tPR views to be the key risks for schemes and tPR's expectations for schemes (in terms of key features of the funding plans it expects trustees to develop) depending on a scheme's circumstances and employer characteristics.

5. TPR REFRESHES GUIDANCE ON PROTECTING SCHEMES FROM EMPLOYER DISTRESS

TPR has refreshed the guidance it produced at the beginning of the COVID-19 pandemic, calling for trustees to remain vigilant to further economic challenges (e.g. increasing inflation, interest rates and energy prices) and how this could affect sponsors. The latest guidance is not significantly different from the version published in November 2020, with the key change being to make the discussion more generic and apply to any circumstances where an employer faces distress, rather than being couched in terms of the COVID-19 pandemic specifically.

The guidance was accompanied by a blog from tPR which emphasises that a robust employer is key and trustees should ensure they have an appropriate understanding of the employers' financial position and potential future challenges. The blog reminds trustees to engage with tPR at an early stage where the sponsor is showing signs of distress.

6. TPR PUBLISHES LDI GUIDANCE

TPR has issued more guidance on using LDI. This replaces tPR's previous October and November 2022 statements. We suspect most trustees are already following the recommendations with their investment managers, although the guidance does include some more specific comments around buffers (see below).

The guidance is clear that trustees are ultimately responsible for how their scheme assets are invested. The guidance is concerned with leveraged LDI (where financial instruments are used to increase allocation in certain assets (such as gilts, index-linked gilts, and fixed income derivatives) and these financial instruments require the trustees to provide collateral to counterparties as security). This is because the use of leveraged LDI brings additional liquidity risks and requirements as these collateral demands can change over short periods when interest rates change.

It sets out specific issues to consider when investing in LDI, including: (1) where LDI fits within the investment strategy; (2) setting, operating and maintaining a collateral buffer and testing for resilience; (3) making sure trustees have the right governance in place; and (4) monitoring LDI. With regard to (2) and collateral resilience, the guidance notes that LDI arrangements need to be resilient to short-term adverse changes in market conditions and therefore trustees need to ensure they have an appropriate buffer to draw on if additional collateral is called for as a result of changing market conditions. This covers two elements: (i) an operational buffer (sufficient liquidity to manage day-to-day volatility in the market); and (ii) a market stress buffer (additional liquidity to provide resilience during severe market stress). The guidance includes more detail on these concepts, including specifying that the market stress buffer should be, at a minimum, 250bps.

At the same time, the FCA has published its own guidance, setting out recommendations for LDI asset managers. (This sets out guidance for FCA-authorised firms providing services in relation to LDI strategies.)

7. TPR PUBLISHES EDI GUIDANCE

TPR recently published guidance for employers and trustees/scheme managers designed to assist those with the power to appoint trustees to improve equality, diversity and inclusion (EDI), based on the belief that diverse groups of people make better decisions.

Broadly, where employers have power to appoint trustees, the guidance encourages them to consider the diversity of characteristics, life experiences, expertise and skills a scheme's trustee body has when identifying candidates, and particularly when recruiting the chair as they play an important role in driving and promoting EDI. The guidance also encourages the appointment of professional pension trustees to address diversity gap challenges where these cannot be met with member-nominated and employer-nominated trustee appointments.

The guidance provides various practical examples to help trustees improve, action and measure the impact of their EDI initiatives, including keeping up with evolving EDI training, developing an EDI policy, regularly reviewing the diversity of the trustee body and making reasonable adjustments for trustee candidates when selecting new trustees.

8. RETAINED EU LAW (REVOCATION AND REFORM) BILL RECEIVES ROYAL ASSENT

The Retained EU Law (Revocation and Reform) Bill which, broadly, would allow for the revocation or amendment of EU law retained in domestic law under the European Union (Withdrawal) Act 2018 and which removes the special features retained EU law has in the UK, received Royal Assent on 29th June 2023, becoming the Retained EU Law (Revocation and Reform) Act 2023.

Some significant amendments were proposed and agreed to the Bill before it received Royal Assent. Most significantly, an amendment was agreed to replace the general sunset clause revoking all retained direct EU legislation and EU derived subordinated legislation from the end of 2023 unless specifically preserved, with a schedule of specific legislation to be revoked. As it stands, much of the legislation included in the schedule to be revoked is out of date or no longer in force.

Another, slightly less helpful, development is that the Lords ultimately accepted the original drafting of the clause which repeals rights under section 4 of the European Union (Withdrawal Act) 2023 at the end of 2023 without replacing them and without these rights being specifically identified. Rather than insisting on their amendment which would have required the Government to specifically identify each section 4 right to be repealed, the Lords intends to rely on the Government's confirmation that it intends to identify the rights to be repealed in updates to its Retained EU Law dashboard (albeit this confirmation from the Government is not legally binding).

9. PENSIONS DASHBOARDS UPDATES: NEW CONNECTION DEADLINE ANNOUNCED AND BILL RECEIVES ROYAL ASSENT

Following the Pensions Minister's announcement in March that the Pensions Dashboard Programme was being "reset" (as discussed in our UK Pensions Update: March 2023), the Government has now announced that the current staging deadlines for different schemes as set out in the Pensions Dashboards Regulations 2022 will be replaced with a single connection deadline of 31 October 2026 for all schemes in scope and draft regulations[1] have been laid to achieve this. However, the intention is for a new staging timeline to be set out in guidance, so in practice, it seems that many schemes will still need to connect before the 2026 deadline.

The draft regulations will also amend the definition of "reference date" to refer to the scheme year falling between 1 April 2023 and 31 March 2024 (currently these dates are 1 April 2020 and 31 March 2021 respectively). This could mean that schemes which previously fell within scope of the regs (at the old reference date) now no longer do so (at the new reference date). For example, where there have been changes to a scheme's membership such that this threshold is no longer met / buy-out has now been completed.

At the same time, tPR has updated its dashboards guidance and also published a blog, stressing the importance of trustees working to progress dashboards quickly and efficiently. It says that the DWP and tPR expect all trustees to be getting to grips with member data to avoid competing demands on capacity and other resources. Guidance from the Pensions Administration Standards Association has also been published. This is designed to support schemes, setting out good practice approaches to providing value data to pensions dashboards. It sets out possible approaches for dealing with difficult issues.

On a separate note, *the Pensions Dashboards (Prohibition of Indemnification) Bill* received Royal Assent on 2 May 2023 becoming the Pensions Dashboards (Prohibition of Indemnification) Act 2023. The Bill makes provisions about prohibiting trustees from being indemnified in respect of penalties imposed under the new regulations which set out duties regarding pension dashboards.

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1 *The Pensions Dashboards (Amendment) Regulations 2023*

10. FURTHER EXTENSION TO THE PENSION FUNDS CLEARING EXEMPTION

New regulations[2] were laid before Parliament on 27 April 2023 and come into force on 12 June 2023 relating to the temporary exemption for pension funds from the obligation to clear certain derivative contracts through a central counterparty ("**CCP**"). The exemption would otherwise expire on 18 June 2023.

As a reminder, the exemption from the clearing obligation for pension funds was introduced because of the specific challenges that pension funds face in meeting margin requirements when clearing through CCPs. CCPs require variation margin (collateral which covers price movements on contracts) – to be provided in cash form. They also have the ability to require variation margin to be posted frequently. Pension funds do not usually hold large cash reserves and therefore meeting CCPs' margin requirements can be more difficult than for other counterparties.

The regulations will extend the current expiry date of the exemption from 18 June 2023 to 18 June 2025. This means that pension funds based in the UK and the European Economic Area will continue to be exempt from the UK clearing obligation. The Government recognises that it would be desirable to put in place a longer-term policy approach and remove the need for future temporary extensions to this exemption. HM Treasury will therefore conduct a review of the pension fund exemption ahead of its new expiry date.

11. PROGRESS ON LEGISLATION FOR PENSION TAX CHANGES

In April, the Committee of the House of Commons debated and agreed certain provisions of the Finance (No 2) Bill.

The Bill includes the draft clauses to implement the pensions tax changes announced in the Budget (please see our UK Pensions Update: March 2023) and there was quite extensive debate on these. In particular, the opposition proposed amendments to the clause which would abolish the Lifetime Allowance ("**LTA**") charge, citing concerns that this would benefit all high earners. Instead, proposals were made to limit the LTA charge removal to NHS staff, or in the alternative, amendments to require the Chancellor to make a statement within a period of the Act being passed setting out the impact of the tax changes and to recommend an alternative approach targeted to NHS doctors.

However, the amendments were rejected and the pensions clauses were ordered to stand in the Bill as drafted. The Bill will now continue to progress through Parliament. It remains to be seen what amendments, if any, will be made to these provisions, but it is expected that they will continue to be subject to extensive debate, particularly given Labour's pledge to reverse the LTA charge abolition if the party comes to power next year.

12. GOVERNMENT CONFIRMS SPA TO INCREASE TO 68 BY 2046 UNDER CURRENT TIMELINE

The State Pension Age is currently set at age 66 and is set to increase to 67 by 2028 and 68 by 2046. The Government is required to regularly review the SPA. On 30 March 2023, the Government published the results of its most recent review, confirming that it intends to keep to its plan to increase SPA to 67 by 2028 and there will be no acceleration in the timeline for the increase in SPA to 68 – with the backstop date of 2046 remaining as is.

However, a further review will be carried out within two years of the next Parliament. This is expected to include updated life expectancy and population projections, such as census data and demographic trends.

13. UK AND US COMMIT TO ESTABLISH UK-US "DATA BRIDGE"

The UK and US have formally announced that they are committed in principle to establishing a "data bridge" for a UK extension to the existing EU-US Data Privacy Framework. No specific timeframe has been announced, although its development is subject to the UK finalising its assessment of US data protection laws and practices and the US designating the UK as a qualifying state. If established, the UK-US data bridge would allow personal data to be

[2] *The Pension Fund Clearing Obligation Exemption and Intragroup Transaction Transitional Clearing and Risk-Management Obligation Exemptions (Extension and Amendment) Regulations 2023*

transferred more easily and more securely between UK entities and certified US entities without the need to rely on alternative mechanisms such as contractual clauses (which can be costly and time-consuming to agree).

Though this development may not impact many UK pension schemes, it may reduce the burden on some schemes with a nexus to the US where this involves the transfer of personal data to the US, e.g. where a scheme has a US sponsor or sponsors in it structure.

14. AUTUMN CONSULTATION FOR AUTO-ENROLMENT REFORM

The Government has announced that it intends to launch a consultation on auto-enrolment reform in the autumn, following the progress of a private members' Bill seeking to extend the scope of the auto-enrolment regime to workers younger than 22 and to reduce or remove the qualifying earnings threshold (the Government has previously backed this Bill). The launch of this consultation is subject to the Bill achieving Royal Assent. Currently, it is due for its second reading in the House of Lords, but a date has not yet been announced. Given the cross-party support that the Bill has received in both Houses to date, it is likely that Royal Assent will be achieved before the Houses go into summer recess in late July.

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