C L I F F O R D

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# UK PENSIONS UPDATE – MARCH 2024

**In this edition, we take a look at how the announcements made in the Spring Budget will affect the UK pensions landscape. We also cover the new consultation on options for defined benefit schemes, the introduction of the Finance Act 2024 and the Pensions Regulator's final General Code, as well as other key pensions developments since our previous newsletter.**

## 1. BUDGET PROMISES ENHANCED INVESTMENT DISCLOSURES TO BOOST UK BUSINESSES

The Chancellor delivered the Spring Budget on 6 March. While nothing substantively "new" was announced on pensions, a number of announcements were made on topics which had already been put on the agenda at the Autumn Statement (for more background, please see the December edition of the UK: Pensions Update). In particular:

**Defined contribution ("DC") investment disclosures/value for money ("VFM") framework**

The government confirmed its intention to bring forward requirements for DC schemes to publicly disclose a breakdown of their asset allocations. It seems that this will form part of the VFM pensions framework which the Financial Conduct Authority ("**FCA**") is expected to consult on imminently.

The consultation will include proposals to require the publication of contract-based DC default funds' historic net investment returns and a breakdown of their UK investments. Proposals will require schemes to compare their performance, costs and other metrics against those of at least two schemes managing over £10 billion in assets.

The government has said it will legislate at the earliest opportunity to apply the VFM framework across the market and provide the Pensions Regulator ("**tPR**") with new powers if necessary to ensure key disclosures are in place by 2027.

This follows the press release published on 2 March in which the Treasury announced that pension reforms were on the horizon as part of the government's plan to boost British businesses, increase returns for savers, and build on the Government's Mansion House compact. (For more details, please see our special edition of the UK: Pensions Update covering the Mansion House reforms).

**Pensions lifetime provider**

The government has confirmed that it remains committed to exploring a lifetime provider model for DC schemes in the long-term (as announced at the Autumn Statement). The Budget confirmed that the government will undertake continued analysis and engagement to ensure that this would improve outcomes for pension savers, and build on the foundations of reforms already underway, including the VFM framework referred to above.

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**State pension increases**

The government also confirmed its commitment to maintain the State pension triple lock (which ensures that the state pension increases by the highest of the rise in average UK earnings, the rise in inflation (measured by CPI) and 2.5%), although did not confirm for how long. The State pension will increase by 8.5% from April.

## 2. DWP LAUNCHES CONSULTATION ON OPTIONS FOR DEFINED BENEFIT ("DB") SCHEMES

The Department for Work and Pensions ("**DWP**") has launched a consultation on "options for DB schemes". The consultation proposes options for the treatment of surplus and the establishment of a consolidator run by the Pension Protection Fund ("**PPF**") by 2026. The consultation follows the Autumn Statement and the call for evidence on options for DB schemes published in July (for more details, please see the December edition of the UK: Pensions Update). The consultation closes on **19 April.**

***Surplus***

Key proposals include:

- introducing a statutory override power to enable schemes to amend their rules to allow for the extraction of surplus on an ongoing basis (a similar power expired in 2016);
- potential changes to the authorised payments regime to enable trustees to more easily use surplus to make one-off payments to members;
- introducing new criteria for permitting the extraction of surplus; and
- introducing a "100% PPF underpin" whereby employers could opt to pay a higher "super levy" to the PPF in exchange for the PPF offering a 100% level of compensation in the event of sponsor insolvency (with a view to giving additional comfort to trustees in return for their agreement to surplus extraction). It is proposed that this benefit "top-up" would need to be funded solely from the super levy.

*This follows the reduction of the surplus tax charge from 35% to 25% which comes into effect from **6 April 2024**.*

***PPF consolidator***

The consultation proposes that the consolidator would primarily target smaller and less well-funded schemes, but the eligibility criteria would be principles-based and work, for example, on the basis that a scheme demonstrates an inability to join a commercial consolidator or secure insurance buy-out.

It would operate as a statutory fund run by the PPF Board and be ringfenced from the PPF's existing funds, whilst operating on a pooled fund basis and in many respects similar to a superfund. The link between employer and scheme would be severed on transfer, apart from in underfunded schemes where the employer would enter into an obligation to pay off the deficit over time.

It is proposed that the consolidator would pay the actuarial equivalent of full scheme benefits to the members of transferring schemes, but under a small number of standardised benefit structures (rather than exactly replicating a transferring scheme's benefit structure). This is to reduce complexity and cost.

The consolidator would be required to meet the same funding targets as commercial consolidators (which will need to comply with forthcoming superfund legislation) and would be expected to have an investment strategy to be fully funded on a prudent Technical Provisions basis in 99% of scenarios over 5 years (the same expectation as for commercial consolidators). To do this, some form of underwriting will be needed – in particular, the

consultation is considering either some form of government underwriting or using some of the PPF's established reserves.

Following publication of the consultation, the PPF has published its initial views on what the consolidator might look like. The PPF says that where schemes are able to access commercially available solutions on reasonable terms, this is likely to remain their preference due to the ability of commercial consolidators to replicate scheme specific benefits. The PPF expects that the new consolidator would be most attractive for the smallest schemes (fewer than 100 members).

The PPF's document confirms that the consolidator would operate on a non-sectionalised basis to maximise efficiencies and economies of scale and would aim to run on (rather than act as a bridge to buy-out) enabling the consolidator to invest for growth over the medium to long term within a set risk budget. The PPF's view is that the government should provide some form of capital buffer (or a facility that mimics the effect of a buffer fund – i.e. a level of capital that the consolidator can draw on in pre-determined scenarios). The PPF does not consider use of their reserves to be a viable alternative.

## 3. FINANCE ACT 2024 GAINS ROYAL ASSENT

The Finance Bill (which contains the provisions to abolish the Lifetime Allowance ("**LTA**") from April) has now received royal assent, becoming the Finance Act 2024.

The Act, amongst other things, introduces the concept of a new lump sum allowance and lump sum and death benefit allowance. The lump sum allowance caps the amount of certain lump sums which can be taken tax-free from registered schemes, and the new lump sum and death benefit allowance caps the total amount of tax-free lump sums, together with serious ill-health lump sums and certain lump sum death benefits which can be paid in respect of an individual from all registered pension schemes. A new "pension commencement excess lump sum" ("**PCELS**") will also be payable in certain circumstances.

The Act also introduces certain reporting obligations and information requirements on scheme administrators.

Schemes will need to familiarise themselves with the changes in order to ensure compliance with the amended regime from 6 April 2024. The legislation itself is not perfect and HMRC has been working with industry representatives to make additional changes to the legislation and provide further guidance ahead of 6 April. In particular, HMRC has acknowledged that concerns have been raised regarding how the PCELS works. New regulations[1] were laid before Parliament on 14 March 2024 (to come into effect from 6 April 2024) and amend the Act to confirm that an individual must have exhausted their lump sum allowance or their lump sum and death benefit allowance to be eligible for a PCELS.

Concerns were also raised that the new regime could have seemingly unintentional consequences for schemes to the extent their rules are written to limit benefits by reference to the LTA (an issue expected to affect only a small number of schemes in practice). While the pensions industry asked for additional regulations to address this, it was unclear whether these would be forthcoming. Helpfully, the regulations published on 14 March do contain a statutory override mechanism (which will cease to have effect on 5 April 2029) designed so that where scheme rules limit a benefit by reference to the LTA, that rule shall automatically be read as continuing to impose that limit as if the LTA had continued to apply. Potentially affected schemes will need to take advice to confirm whether the statutory override is sufficient to address identified issues, or whether a rule amendment may be preferable in advance of 6 April.

## 4. PROGRESS ON CHANGES TO DB FUNDING REGIME

### Updated funding regulations

At the end of January, the DWP published its response to the consultation on the draft *Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2023*, together with a final draft of the

[1] *The Pensions (Abolition of Lifetime Allowance Charge etc) Regulations 2024.*

regulations. There have been several helpful improvements made to the draft version of the regulations previously published.

**Key updates**

- **Concepts of maturity and significant maturity**: The final regulations have retained the concept that tPR will specify the duration of liabilities for the purposes of the definition of "**significant maturity**" in the Code. The definition of "**maturity**" has, however, been updated in several respects to confirm the measure which should be used for measuring the maturity of a scheme and provide a fixed date on which economic assumptions used to calculate maturity must be based. The position for open schemes has also been amended.

- **Relevant date**: The final regulations now distinguish between schemes that have and have not reached significant maturity. New provisions have also been included specifically for cash balance schemes.

- **Low dependency investment allocation**: In the consultation response, the DWP recognises that the draft regulations could have been interpreted in a way that interferes with trustees' investment powers. The references to complying with an investment objective have now helpfully been removed, as has the requirement for assets to be invested in such a way that the cash flow from the investments is *broadly matched* with the payment of benefits from the scheme. The regulations are therefore now much clearer that they are not imposing an *obligation* on trustees to *invest* in line with a low dependency investment allocation and the consultation response confirms the intention is that these regulations should not change trustees' investment powers.

- **Statement of strategy:** Some changes have been made to the level of detail and the supplementary matters schemes need to provide within the statement of strategy, with a view to reducing the administrative burden.

- **Recovery plans**: the regulations now provide that in determining whether a recovery plan is appropriate, the trustees must follow the principle that the duration for the recovery plan must be as soon as the employer can reasonably afford (changed slightly from the original draft) and include a new requirement that in preparing or revising a recovery plan, the trustees must consider the impact of the recovery plan on the employer's sustainable growth.

- **Employer covenant**: the definition of "**strength of the employer covenant**" has been changed in a few key respects and references to considering factors as set out in the Code in assessing the financial ability of the employer have been removed – the DWP says it agrees that it is important to maintain the primacy of the regulations.

Subject to Parliamentary approval, the intention is that the regulations will come into force from **6 April 2024** and apply to scheme valuations with effective dates on and after **22 September 2024.**

**Consultation on statement of strategy**

On 5 March, tPR published a consultation on the new statement of strategy. The consultation seeks views on the proposed approach to the statement, including the proposed form of the document, and the type and extent of the information that will need to be submitted. The consultation closes on **16 April**.

TPR proposes that the statement of strategy should be in a standard form and follow a set template. Schemes will be required to produce this to document their long-term funding and investment strategy and submit this to tPR in this template. TPR will produce separate templates to reflect the fact that schemes will have to provide slightly different information depending on whether they have reached the relevant date (of significant maturity), or whether they are taking a Fast Track or Bespoke approach. The consultation proposes to request less information from smaller schemes.

The consultation pack includes an example draft statement of strategy template for a scheme submitting a Bespoke valuation submission before the scheme's relevant date; a worked example of how tPR expects maximum affordable

contributions to be evidenced (where required); and a data list setting out what information tPR anticipates DB scheme trustees will be required to provide for insertion into the template.

**Related updates**

- The response to the consultation on the draft DB Funding Code (and the consultation on the Fast Track guidance) is still awaited but is expected this Summer.
- A consultation on covenant guidance is also expected this Summer.

## 5. REGULATOR PUBLISHES GUIDANCE ON PRIVATE MARKETS INVESTMENTS

TPR has published guidance for trustees on private market investments. The guidance emphasises that with the right advice and governance, "private market" investments (defined as private equity, private debt, private real estate and infrastructure and natural resources) "*can play a valuable part in a diversified portfolio that aims to improve and protect saver benefits*". This follows the Chancellor's Mansion House speech last summer (as discussed above) and aims to encourage schemes to consider investment in private markets.

The guidance explains how to access private markets and secondary markets, the risks and benefits of illiquid investments, valuing private market assets, and key considerations when deciding whether to invest (including ensuring there is adequate trustee training and knowledge on this type of investment).

## 6. TPR PUBLISHES FINAL GENERAL CODE

TPR's long-awaited General Code (together with the consultation response) has now been published and is expected to come into force on **27 March 2024**. It replaces 10 of tPR's pre-existing 15 Codes. In practice, we would not expect the Code to result in significant changes for most well-run schemes.

**Key points**

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| **Trustee meetings and decision making** | TPR has changed the expectation on publication of trustee minutes. The Code now says trustees should simply seek to engage with members about their activity. |
| **Effective system of governance ("ESOG")** | Trustees of most occupational schemes must establish an effective system of governance.<br><br>In the consultation response, tPR says that it considers that the ESOG is predominately a "rebadging" of things that trustees of well-run schemes should be doing already.<br><br>Trustees should ensure that the elements of their ESOG are subject to a regular internal review. This review may be carried out as part of an ORA (see below). Otherwise, each ESOG should be reviewed at least every three years. |
| **Own risk assessment ("ORA")** | Trustees of schemes that must contain an ESOG must carry out and document an ORA as part of the ESOG. The ORA will identify the key governance risks facing the scheme.<br><br>TPR has updated the Code to reduce the workload needed to draft an ORA, saying it should be "straightforward" for any well-run scheme.<br><br>The final Code confirms that the ORA can reuse material that examines the same areas covered by a scheme's existing risk assessment processes if they fall within the applicable timeframe. |
| **Risk management policy** | Trustees of schemes which are required to operate an ESOG should have in place a risk management function. |

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| | There should be a written policy regarding the operation of the risk management function which should be approved by the trustees and reviewed at least every three years. |
| **Remuneration policy** | Schemes subject to the ESOG requirement with 100 or more members should establish a remuneration policy and keep a written record of it. This should set out the principles for determining pay f(or those undertaking activities in relation to the scheme, including service providers) and the decision-making process for payment levels.<br><br>TPR says this policy only needs to cover those costs the trustee is directly responsible for (meaning that in a scheme where the employer bears all costs, this policy will be very short).<br><br>The expectation to publish the remuneration policy has also been removed. |
| **Continuity planning** | Trustees should develop and implement continuity plans to ensure that their scheme operations can be maintained, in the event of a disruption to scheme activities. |
| **Investment decision-making** | The consultation response confirms the expectation that schemes should have no more than 20% of scheme investments held in unregulated investments has been removed. It now refers to investing "mainly" in regulated markets. |

## 7. HIGH COURT GIVES JUDGMENT ON SEVERING "VALID" PARTS OF AMENDMENTS

The High Court recently handed down its judgment in *Avon Cosmetics Ltd*[2], clarifying the test to be applied by the court in considering whether to partially uphold the "valid" part of an amendment that was otherwise invalid (in the context of an amendment which partially infringed the restriction in the scheme's amendment power).

The case concerned a Part 8 claim by the Avon Plan's principal employer regarding the validity of a rule amendment. Ultimately, the judge ruled that the amendment was valid for certain members even if it had not been valid in respect of other members.

While the case turned on its facts and the specific wording of the amendments, some general points to take away include:

- where there is an excessive exercise of power, the courts will naturally incline to uphold the validity of the exercise if possible i.e. if the valid and invalid parts of the exercise are conceptually different and can be separated.

- the court must be satisfied that the trustees would have still exercised the power in the same way if they had appreciated the limitations on the power (the "would still have been exercised" test). However, this is an objective test whereby the courts should consider whether the valid part of the amendment could stand on its own and would fall within the broad intention/purpose of the exercise of power, without considering the state of mind of the trustees.

[2] *Avon Cosmetics Ltd v Dalriada Trustees Ltd [2024] EWHC 34 (Ch)*

CLIFFORD CHANCE

# CONTACTS

**Hywel Robinson**
Partner

T +44 20 7006 8387
E hywel.robinson
@cliffordchance.com

**Clare Hoxey**
Partner

T +44 20 7006 8899
E clare.hoxey
@cliffordchance.com

**Sarah McAleer**
Partner

T +44 20 7006 8808
E sarah.mcaleer
@cliffordchance.com

**Louise Oliver**
Senior Associate
Knowledge Lawyer

T +44 20 7006 4152
E louise.oliver
@cliffordchance.com



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www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

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