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# Current issues

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## New year, new Code

The Pensions Regulator's General Code of Practice was, after an elephantine gestation period, presented to Parliament on 10 January 2024. Likely to come into force in late March 2024, it will consolidate and update much of the Regulator's guidance on the legal responsibilities of, and expected standards of conduct and practice for, the trustees and scheme managers of occupational, public-sector and personal pension schemes.

The Code in its final form is not greatly changed from the version proposed in March 2021. One notable difference is in the expected frequency of trustees' 'own-risk assessments', which has been aligned with legislation and become less onerous.

### Code contents

The General Code contains modules that will replace ten subject-specific Codes:

- 1: Reporting Breaches of the Law
- 4: Early Leavers
- 5: Reporting of Late Payment of Contributions to Occupational Pension Schemes
- 6: Reporting of Late Payment of Contributions to Personal Pension Schemes
- 7: Trustee Knowledge and Understanding (TKU)
- 8: Member-nominated Trustees/Member-nominated Directors—Putting Arrangements in Place
- 9: Internal Controls
- 11: Dispute Resolution—Reasonable Periods
- 13: Governance and Administration of the Occupational Trust-based Schemes Providing Money Purchase Benefits
- 14: Governance and Administration of Public Service Pension Schemes

The Code applies to the 'governing bodies' of occupational, personal and public-sector pension schemes, setting out their responsibilities in the areas covered by the soon-to-be superseded Codes listed above, as well as some newer ones such as cyber controls and climate-risk governance. The final version of the Code has been revised to address concerns raised by commentators who pointed out the various entities—scheme managers, advisory boards, pensions boards, pensions committees—that could be considered to have governance roles in the public sector pensions sphere.

## Effective systems of governance

The most eagerly awaited sections of the General Code are likely to be those laying down the Regulator's expectations for an 'effective system of governance' (ESOG) in private-sector occupational schemes.[1] Brought in via EU Directive 2016/2341 (better known as 'IORP II'), the ESOG obligations extend the previous requirement for trustees to establish and operate adequate 'internal controls'. (Public-sector schemes must also have internal controls, but under a separate UK legal provision.) The elements of the ESOG must be proportionate to the characteristics of the scheme.

## Own-risk assessments

Trustees of occupational pension schemes with 100 or more members will also be required to carry out periodical 'own-risk assessments' (ORAs) of the effectiveness of their governance systems. Failure to do so may be taken as evidence of poor governance. A scheme's first ORA must (generally) be done and documented within twelve months of the end of the first scheme year to begin after the Code's issuance (so, for example, a scheme with a 31 March year-end will be expected to complete its first ORA exercise by 31 March 2026). However, the Regulator says that it is not necessary that all aspects of the ORA are undertaken at the same time, and that it could be a collation or index of existing risk assessments. Nevertheless, the ORA should be documented in writing and signed off by the trustee chairperson. Subsequent ORAs must be undertaken at least every three years (the Regulator says that assessment of individual elements covered by the ORA should be undertaken when there are material changes).

## Key functions

Private-sector occupational schemes with 100 or more members are also expected to have the capacity to undertake certain 'key functions'. Those responsible for the risk-management function are expected to keep the scheme's key risks, and the interdependencies between them, under review; to also consider the position from the perspective of the scheme's beneficiaries; and to report their findings to the governing body 'in a timely manner'. Schemes should have written policies on their risk-management function, and review them at least triennially.

The IORP II Directive also requires that schemes have an internal audit function, tasked with evaluating adequacy and effectiveness of the system of governance. The UK's implementing legislation also refers to this key function, without using the phrase 'internal audit'. The Code discusses the role of internal auditor, but does not label it as a key function. It says that it could be undertaken by someone responsible for internal audit within the sponsoring employer's organization, provided they have the requisite knowledge of pensions matters, and that any actual or potential conflicts are properly considered.

## Cyber controls

A scheme's internal controls should include measures to manage cyber risks (the legal obligations are somewhat different for public-sector schemes, but the Regulator says that the adoption of cyber-risk measures is good practice in any case). It is expected that, amongst other things, governing bodies have knowledge and understanding of risks, establish clear roles and responsibilities, assess their vulnerabilities and those of their service providers, ensure that critical systems are regularly backed up, and have suitable policies and a cyber incident response plan.

## Remuneration policies

Private-sector occupational schemes with 100 or more members will need a written remuneration policy, covering everyone (service providers included) who carries out scheme activities, where paid by the trustees. This is a change from the draft Code, which suggested that sponsor-renumerated roles should also be included; the Regulator has also removed an expectation that the policy should be disclosed to members.

## What comes next?

The Code cannot come into effect until it has lain before Parliament for forty days without either House passing a resolution against it. The Department for Work and Pensions must then make an order (statutory instrument) specifying the effective date. The in-force date is currently expected to be 27 March 2024.

Trustees who paused governance reviews pending the Code's completion can now resurrect those projects, and begin preparation for their first ORA.

[1] The UK's ESOG legislation does not apply to authorized (DC) master trusts or collective money purchase schemes.

## Plink, plink, FIS: new funding & investment remedies administered

The Department for Work and Pensions (DWP) has announced the outcome of proposed reforms to the defined benefit (DB) funding rules, addressing concerns that the new regime will be unduly restrictive. Final Regulations have been laid before Parliament, with the expectation that they will come into force on 6 April 2024, and apply to valuations with effective dates from 22 September onwards.

### Funding & investment strategies

As a reminder, the reforms will mean that trustees are expected to formulate a 'funding and investment strategy' (FIS), whereby their scheme will be fully funded, with low dependency on additional employer contributions, high resilience to market volatility, and sufficient liquidity to meet its cash-flow requirements, by the time that it reaches 'significant maturity'. These fundamentals of the new regime are still to be found in the re-drafted FIS Regulations. However, the DWP has made several changes to the details in response to consultation feedback, making it clearer that there is continued scope for scheme-specific flexibility and appropriate risk-taking. It paves the way for a revised Code of Practice from the Pensions Regulator (TPR) to give detailed guidance on how schemes can comply with the legislative requirements.

### Maturity

The initial draft legislation raised concern that the 'duration of liabilities' method prescribed for determining scheme maturity would prove to be overly sensitive to market events. The DWP does not want to oblige trustees to make needless strategy revisions, so now the economic assumptions for the maturity calculation must be based on conditions on 31 March 2023. The duration of liabilities at which a scheme is taken to reach 'significant maturity' will be established in TPR's Code (the draft proposed that it be set at twelve years, but it will be reassessed in light of market conditions). Schemes that have already passed the point of significant maturity by the time they produce their FIS will base it around the effective date of the associated actuarial valuation.

The final Regulations explicitly permit trustees of open schemes to make allowances for the admission of new members and for future accrual, provided that their assumptions are appropriate to the strength of the employer covenant. This could mean that a scheme is not expected to mature significantly in the foreseeable future. The Government hopes that this will allow the trustees to invest more in growth assets for the long-term.

### Low dependency investment allocation

There was also concern that the requirement for the FIS to assume a 'low-dependency investment allocation' (LDIA), once a scheme has reached significant maturity, would inappropriately constrain trustees' investment discretion. The DWP has, in response: amended the LDIA definition to remove reference to cash flow from assets being broadly matched with benefit payments; downshifted the LDIA from a 'principle' (which must be followed) to an 'objective' (that must be taken into account); and phrased the objective so that it applies only to assets backing the minimum funding level, and not any surplus. Again, it hopes that this will allow trustees to hold growth-seeking assets for longer. The consultation response says that whilst TPR will generally expect trustees to invest in ways consistent with the FIS, '*there may be good reasons for some divergence*.'

### Employer covenant

The initial draft Regulations were notable for explicitly requiring, for the first time, that regard is had to 'the strength of employer covenant'. The DWP has tweaked the phrase's definition to position the strength of the employer covenant in relation to the sponsor's legal obligations to the scheme, to require that wider consideration is given to factors affecting the employer's future capacity to support the scheme, and to remove any implication that contingent assets are limited to guarantees.

### Journey planning

The Regulations establish principles about the level of risk that trustees can take in the assumptions underlying their 'journey plan' toward significant maturity. The DWP has focused the journey plan on funding matters, removing proposed principles about investment risk so that it is no longer an element of the FIS for which employer agreement must be obtained.

When formulating their FIS, trustees will be required (amongst other things) to follow the principle of investing to provide sufficient liquidity to meet expected cash-flow requirements and make reasonable allowance for *un*expected needs. The DWP has removed requirements to anticipate liquidity needs over the entire journey plan, and after the point of significant maturity, in answer to concern about the costs of planning for liquidity too far into the future.

### Statement of strategy

Trustees will be required to prepare and maintain a 'statement of strategy' that describes their FIS, evaluates the progress toward and risks to implementation, and reflects upon their decision-making. The DWP has revised the information and level of detail to be provided with the intention of making the statement less onerous. It has given TPR discretion to set the level of detail appropriately, and reduced the number of supplementary matters that must be covered. Whilst the statement will now need to incorporate a summary of the associated actuarial valuation, trustees will no longer need to supply that information alongside recovery plans submitted to TPR. Copies of statements will generally need to be sent to TPR as soon as practical after they are prepared or revised.

### Recovery plans

One of the more controversial aspects of the initial draft Regulations was the requirement for trustees to eliminate funding deficits as quickly as the employer can reasonably afford. Although that principle has long formed part of TPR's calculus, many commentators were concerned about the implications of enshrining it in legislation ahead of other considerations. Although the DWP has retained the principle that deficits should be recovered as quickly as is affordable, it has now tempered the effect somewhat by requiring that trustees consider the impact of the recovery plan on the sponsor's sustainable growth.

### Other news

The DWP published an updated Impact Assessment with its consultation response. It estimates that around 1,200 schemes will pay additional deficit recovery contributions (DRCs), totalling approximately £7.1bn over the next 10 years, though this analysis pre-dates recent market moves. The total initial costs of implementing the new requirements are estimated at around £36.8 million, with additional ongoing costs of about £5.4 million each year.

The Pensions Regulator is reconsidering the parameters for its 'Fast Track' compliance route, in light of consultation responses and changes in market conditions, and will publish details alongside the finalized Code of Practice. We understand that the plan is for the Code to be laid before Parliament in late May or early June 2024, in order for it to be in force for September.

It's good to see that the DWP has listened to the industry in so many areas, with revisions addressing some of the biggest concerns. After numerous delays, the wheels finally seem to be in motion for a 2024 launch of the revamped regime. However, trustees will need to wait for TPR's Code of Practice to understand precisely how it will operate in practice.

## The Regulator's guide to the private-markets galaxy

The Pensions Regulator has published guidance for trustees on private-market investments. It says, in summary, that such investments can contribute to good member outcomes, if trustees consider their options properly and have the right governance systems in place.

The guidance introduces the different categories of private-market assets; discusses the potential reasons for investing in them, and the risks involved; places them in the context of trustees' investment duties; suggests some key trustee considerations; describes how the considerations differ for defined benefit and money purchase schemes; and points to some additional resources.

## HMRC newsletters: January 2024

Pension Schemes Newsletter 155 confirms that His Majesty's Revenue and Customs (HMRC) is aware of potential problems with some of the clauses in the Finance Bill 2023/24 concerned with the abolition of the lifetime allowance from 6 April 2024. It is considering whether changes are required.

The problematic provisions relate to—

- the pensions commencement excess lump sum, where the method of calculating the maximum payment is thought to create difficulties for members with multiple pension arrangements;
- scheme-specific lump sum protection, the formula for which currently multiplies one element by the wrong number;
- the new 'reportable event' concerning lump sum payments, which needlessly requires reporting of sums paid within members' allowances; and
- aspects of the taxation of death-benefit lump sums, which do not presently reflect the reality that HMRC will liaise with the member's personal representatives (not scheme administrators) for that purpose.

The Newsletter also has answers to several abolition-related FAQs. For example:

- a member need only have some lump sum allowance remaining to be eligible for a trivial commutation or wind-up lump sum (assuming the other conditions are met);
- members over age 75 will now be able to receive uncrystallized funds pension lump sums, because there will be no deemed crystallization event at that age;
- taxable lump sums other than lump sum death benefits will count as income for tapered annual allowance purposes;
- lump sums from funds crystallized before 6 April 2024 will not be assessed to tax again if paid after that date;
- members who have entirely used up their lifetime allowances, but took less than their maximum pension commencement lump sums, may still have some access to the new lump sum allowances if they obtain transitional tax-free amount certificates;
- members who wish to apply for transitional tax-free amount certificates should do so before their first relevant post-5 April 2024 benefit crystallization event (the Newsletter says that the application for the certificate must be made to the scheme paying that first lump sum, which is not what the Bill currently requires); and
- statements issued to members after relevant benefit crystallization events should show amounts (rounded down to the nearest pound), not percentages.

HMRC intends to publish further information about the lifetime-allowance abolition legislation every couple of weeks.

The Newsletter also contains—

- updates for administrators of relief-at-source schemes;
- the latest pension flexibility statistics;
- information about changes to NI records in connection with retrospective admission of retained firefighters to their statutory schemes;
- how users of the Pensions Schemes Online (PSO) and Managing Pension Schemes (MPS) services may regain access if their credentials have lapsed; and
- news about the MPS service (including deferment of the facility to submit pension scheme returns, so that 2023/24 returns will need to be given using Pension Schemes Online).

# Pension increase & revaluation news

## GMPs in payment

The Department for Work and Pensions (DWP) has laid before Parliament a draft of the Guaranteed Minimum Pensions (Increase) Order 2024, which would determine the uplift due to GMPs in payment, from 6 April 2024, in so far as they relate to the tax years 1988/89 to 1996/97. As expected, given the 6.7% increase in the Consumer Prices Index for September 2023, the draft Order provides for the maximum 3% increase required under the legislation.

The House of Commons approved the Order after a debate on 31 January 2024.

## Public Sector

His Majesty's Treasury has announced details of this year's increases to public sector pensions in payment and in deferment.

Pensions that have been in payment for a year or more will increase from 8 April 2024 by 6.7%, in line with Consumer Prices Index (CPI) inflation over the year to September 2023, with proportionate increases to pensions commenced more recently. The same percentage will govern revaluation in deferment in the historical, final salary schemes. Revaluation in the newer, career-average revalued earnings (CARE) schemes will be based either upon prices inflation of 6.7% or earnings inflation of 7.7%, depending on scheme rules.

The Treasury has published multiplier tables to enable the calculation of cumulative increases due over multi-year periods.

# Post-Brexit re-write for PPF valuation guidance

The Pension Protection Fund (PPF) has updated its suite of valuation guidance, effective from 1 January 2024. It was prompted by the changed status of EU-derived law, specifically the court decisions in the *Hampshire*[1], *Hughes*[2] and *Bauer*[3].

As a brief reminder, the *Hampshire* and *Hughes* judgements required that the value of PPF compensation must be at least 50% of the value of the benefits to which the person would have been entitled under the rules of their scheme. The *Bauer* judgement would, additionally, have required the PPF to provide a minimum level of benefit so that the member would not have to live below the threshold for an EU measure of poverty.

For the most part, the revised guidance merely ensures that current practices are continued. The *Hampshire* value test is reflected in the new guidance for section 143 (and 152 and 156) valuations, which are used to determine eligibility for entry into the PPF. For section 179 valuations, used for levy-setting purposes, the PPF confirms its previous conclusion that no allowance need be made for the value test.

Since the effect of the *Bauer* judgment has not been preserved in UK law, no allowance should be made for it for assessment periods commencing on or after 2 January 2024, nor in section 179 valuations.

# The PPF, the FAS, and the terminally ill

The Pensions (Special Rules for End of Life) Bill, a Private Member's Bill sponsored by Laurence Robertson MP, is due for a Second Reading on 2 February, and seems to have Government support. It would change the Pension Protection Fund (PPF) and Financial Assistance Scheme (FAS)'s definitions of 'terminally ill', so that they apply in future to people with life expectancy of less than a year, rather than (as at present) six months. The change would mirror one made recently in connection with social security benefits.

## And Finally…

The House of Commons Work and Pensions Committee recently grilled the Pensions Minister and Economic Secretary to the Treasury (together with a brace of senior civil servants—senior civil servants are always encountered in braces) on the subject of defined benefit pension schemes. This was the occasion for numerous frightfully entertaining exchanges, such as the following:

> [Nigel Mills] … *we have been on a bit of a roller coaster ride with pensions. Do you think we are now off the rollercoaster and heading for an ice cream, or are we just in the pause at the top before we start going up and down and upside down again?*
>
> [Paul Maynard] *I very much hope we are getting off the rollercoaster and having some Blackpool rock, which is very solid, secure and predictable.*
>
> [Bim Afolami] *It's very bad for your teeth, though.*
>
> [Paul Maynard] *You should never bite off more than you can chew.*

That was not the last extended—a less kind person might even venture to call it 'strained'—metaphor that we heard of, though:

> [Nigel Mills] … *are we envisaging the lifeboat going out and proactively rescuing ships that we know are going to sink at some point but just haven't quite sunk yet, or are we envisaging it going out and taking passengers off ships that aren't going to sink but which may not be attractive to other ships at some other point?*
> *… …*
> *The levy is for ships that sink, not for ships that don't move quite fast enough.*

The Pensions Minister also took the opportunity to educate the Committee about the relative chronological rankings of the various non-specific timescales commonly used in Government promises. We learned that '*imminently*' implies a more proximate delivery time than '*sooner rather than later*', which in turn beats '*in due course*'. One feels that this should be the basis for a new chapter in *Erskine May*, the Bible of parliamentary procedure.

*AF* will leave you there, borrowing the sign-off given by the Minister:

> *I think you have heard quite enough from me…*



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