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Long-awaited DB funding & investment legislation aired

The Department for Work and Pensions (DWP) has published an eagerly-anticipated consultation draft of the legislation necessary to implement scheduled reforms to the defined benefit (DB) funding regime.[1] The main outcome would be a statutory requirement for long-term planning, but the revisions would have the side effect of obliging DB trustees to appoint a chairperson, and would also clarify what makes a recovery plan ‘*appropriate*’. This paves the way for the Pensions Regulator to launch a second consultation into its funding Code of Practice, later in the year.

Recap

The *Pension Schemes Act 2021* contains amendments that would require trustees to prepare and maintain—with the agreement of their sponsor(s)—a ‘*funding and investment strategy*’ (FIS). Regulations are required to bring the provisions into force and to fill in the details of the legal obligation. The Regulator has been working on a new funding Code of Practice in parallel with the legislative developments: its proposed twin-track (‘*Fast Track*’ versus ‘*Bespoke*’) routes to compliance, and most notably the crucial Fast Track parameters, are *not* part of this DWP consultation exercise.

Getting busy with the FIS-y

Extending and amending the current scheme funding legislation, the draft Regulations look to embed the key principles in law whilst leaving the details of how things should operate in practice for the Regulator to fill in. Trustees and sponsors would need to agree on a FIS within fifteen months of the effective date of the first actuarial valuation obtained after the legislation comes into force (some time in 2023, it is suggested). Thereafter, FIS reviews would be required within fifteen months of each subsequent valuation, or as soon as reasonably practicable after any material changes to the circumstances of either the scheme (for example, affecting its funding or maturity levels) or the employer (for instance, in the strength of its covenant).

The goal of the draft legislation is for trustees to plan on the basis that, by the time their scheme reaches ‘*significant maturity*’, it has sufficient assets, and is invested in such a way, that there should be no need (barring unforeseeable events) for additional employer contributions to provide the benefits then accrued. A scheme becomes increasingly mature as the proportion of benefits that have come into payment increases. The proposed measure of the maturity of a scheme, for the purposes of the new legislation, would be the average time until the payment of benefits, weighted by the discounted payments. The Code of Practice would define what constitutes ‘*significant maturity*’: the consultation document suggests that the Regulator will propose a duration of liabilities of twelve years as the point at which significant maturity is

[1] <www.gov.uk/government/consultations/draft-occupational-pension-schemes-funding-and-investment-strategy-and-amendment-regulations-2023>.

attained. The expected timing of significant maturity would need to be reviewed whenever the FIS is (that is, at least triennially).

The FIS would have to be drafted on the basis that, by the time a scheme reaches significant maturity (specifically, by the end of the scheme year in which that occurs), the cash flows from its investments match (broadly) its benefit payments, and the value of its assets relative to its liabilities is highly resilient to adverse short-term market swings. The strategy would also assume that, by that time, the scheme will be fully funded, on a basis that assumes that no further employer contributions should be necessary to provide the accrued benefits.

The levels of investment and actuarial risks that could be taken by the trustees in accordance with the FIS as the scheme proceeds towards significant maturity would depend on how close it is to that point and, chiefly, on the strength of the employer covenant. The draft Regulations contain rules for assessment of covenant strength upon which the Regulator would issue guidance. The stronger the covenant, and the further the scheme is from significant maturity, the more risk can be borne. The strategy would need to be drafted on the understanding that, by the time the scheme reaches significant maturity, its investments will be liquid enough to match its expected cash flow requirements, and make reasonable allowance for unanticipated demands.

The draft Regulations recognize that, in practice, this '*low dependency*' approach may differ from the trustees' *actual* end goal. They would need to explain, in their FIS, their plan for providing the scheme's benefits in the long term (for example, by allowing the scheme to 'run on', transferring to a consolidator, or buying out with an insurer).

Making a statement

As soon as reasonably practicable after each FIS review, the trustees would need to prepare a written statement of strategy, that (as well as describing the FIS) would assess their performance against the FIS (and any remedial action required to get back on track), the risks faced when implementing it (and what they can do to mitigate them), and what they have learned from the decisions that they have taken along the way. It would also need to set out the current state of play and likely future development of various factors crucial to the scheme's journey plan: scheme maturity, investment and actuarial risks, liquidity, funding level, actuarial assumptions, and employer covenant. The scheme sponsor needs to be consulted about the contents of the statement of strategy, and may make comments for inclusion in it.

Statements of strategy would need to be in a form set by the Regulator, and would be submitted to it alongside actuarial valuations (which would in future have to be sent regardless of whether they disclose a deficit or not). The statement would have to be signed by the chair of the trustees: the legislation would require the appointment of a chair if the scheme does not have one already.

Planning appropriately

When an actuarial valuation shows that a scheme has a funding deficit, the trustees are obliged to prepare or revise a recovery plan that is '*appropriate having regard to the nature and circumstances of the scheme.*' The draft Regulations would amend the rules on the preparation of recovery plans to say that, when determining whether a plan is '*appropriate*', the trustees '*must follow the principle that funding deficits must be recovered as soon as the employer can reasonably afford.*'

What comes next?

Comments about the proposed legislation should be submitted by 17 October 2022. The Regulator intends to take the draft Regulations into account when composing its revised Code of Practice on DB scheme funding, which it expects to consult upon in the autumn; if things to plan the Code is expected to launch in late 2023 or early 2024. The DWP would be obliged to review the effectiveness of the new provisions at least every five years.

The draft Regulations begin to sketch out the form of the revised funding regime, but do not themselves tell us much that is new. They will, however, allow the Regulator to proceed to the second stage of consultation on its new funding Code, which will confirm how it is all expected to operate in practice—particularly the details of the proposed 'Fast Track' and 'Bespoke' funding approaches. For now, trustees and sponsors will need to press ahead in the knowledge that significant changes are coming down the line: the draft Regulations and the (hopefully) imminent Code consultation will help with those preparations.

DWP tweaks Dashboards Regulations based on consultation feedback

The Department for Work and Pensions (DWP) has responded to comments received about the draft Pensions Dashboards Regulations that it circulated in January 2022.[2] Several amendments have been made to its policy and the forthcoming legislation as a consequence of the feedback. A separate summary of the policy decisions was later published as a supplement to the main report.[3]

The DWP's response summarizes the extent of trustees' responsibilities, and the activities for which they will *not* be responsible: for example, verifying identities, authorization of view requests, and data processing by qualifying pensions dashboards services (QPDSs). It underlines the importance of data readiness, a point emphasized in the Pensions Minister's press release.[4]

There will be some consequential changes to the Regulations, compared to the draft circulated in January. For example:

- Value (broadly, accrued benefit) data for new members will have to be provided as soon as practicable, and no later than the earlier of (i) first statement date and (ii) twelve months after end of the member's first full scheme year (bulk-transferred members will be considered 'new');
- There will be flexibility to choose the best approach to tranches of defined benefits (DB), either providing a combined value at a single retirement date, or separate values and dates for each tranche;
- Somewhat simplified illustrations of revalued deferred DB will be permitted during the first two years after connection to the dashboards system (adjusting leaving benefit by an inflation measure or in accordance with Revaluation Orders), so long as they are not misleading and the calculation would otherwise entail disproportionate costs or timescales;
- There will be no need to annualize cash balance amounts if the benefit is designed to provide a lump sum (most likely a pension commencement lump sum);
- In connection with the *McCloud* discrimination issue in the public sector, the requirement to present two values will be restricted to schemes in which the '*deferred choice underpin*' will operate (so, not the Local Government Pension Scheme);
- Trustees will have more discretion to choose the most appropriate valuation approach for unconventional hybrid-benefit formulae;
- Annualized values will be calculated as though the member reached retirement date on the illustration date;
- References to '*normal pension age*' are being changed to '*retirement date*';
- The actions required in the event of a 'possible match' will be clarified;
- Providers will be allowed to quote values from statements issued within the last *13* months (values based on non-statement calculations must still have been produced within the last 12 months); and
- There are changes to how the rules will apply to schemes that are under assessment for the Pension Protection Fund (PPF) or in wind up.

Staging deadlines

The DWP has made a '*modest change*' to the staging deadline for the first two cohorts to connect to the dashboards system: authorized master trusts and money-purchase auto-enrolment scheme, where they have at least 20,000 '*relevant*' (active and deferred) members. In this case '*modest*' means a two-month delay. The deadline for public sector schemes is being deferred by five months, to 30 September 2024, and the requirement to provide value data will be pushed back to 1 April 2025. Hybrid schemes will now ascertain the total relevant membership and determine the staging deadline as if they were fully non-money purchase, so that none will have a deadline earlier than 30 November 2023. Applications to the DWP to defer staging will have to be submitted at least two months before the prescribed deadline (and within the year following the in-force date for the Regulations). The PDP will provide a 'sandbox' facility in which schemes' connections to the dashboards system can be tested before their connection windows open.

It is proposed that data standards will allow trustees to gather data about additional voluntary contributions (AVCs) to present alongside their main scheme benefits, or for the AVC provider to provide it separately (in which there will need to

[2] <www.gov.uk/government/consultations/pensions-dashboards-consultation-on-the-draft-pensions-dashboards-regulations-2022/outcome/government-response-draft-pensions-dashboards-regulations-2022>.
[3] <www.gov.uk/government/consultations/pensions-dashboards-consultation-on-the-draft-pensions-dashboards-regulations-2022/outcome/summary-of-key-policies-draft-pensions-dashboards-regulations-2022>.
[4] *Minister Calls on Pension Schemes to Get "Data Ready" for Dashboards* <www.gov.uk/government/news/minister-calls-on-pension-schemes-to-get-data-ready-for-dashboards>; https://twitter.com/TPRgovuk/status/1547587837255507972?s=20&t=9mMYeEr2AuXFYcMry3tr2A.

be a notice to indicate the connection between the two values). Either way, the trustees will be responsible for ensuring that the data is available.

Standards consultation

The Pensions Dashboards Programme (PDP) established by the Money and Pensions Service (MaPS) subsequently began consultation on its approach to standard setting, and the initial set of dashboards standards.[5] Responses should be submitted by 30 August 2022.

Dashing towards dashboards deadlines

The Pensions Regulator has warned trustees to prepare their schemes ahead of the pensions dashboards deadlines.[6] The injunction comes as the Regulator's research indicates that the majority of trustees have yet to prepare their schemes for connection to dashboards, and are at risk of failing to meet their legal responsibilities.

The announcement follows the publication of new guidance to help trustees meet their dashboards obligations.[7] This guidance is based on draft Regulations consulted on by the Department for Work and Pensions, and the subsequent consultation response published in July 2022[8]. The guidance sets out the legal duties of trustees, and contains a checklist to track progress made as a scheme approaches its connection deadline. The checklist breaks down the key considerations for trustees into four categories: connection, governance, matching savers to their pensions, and providing pensions information to savers. It is anticipated that significant work will be involved in successfully connecting a scheme to the pensions dashboards system to allow savers to securely access their pension information at a single online location.

According to the Regulator's research, 51 per cent of defined contribution (DC) schemes and 33 per cent of defined benefit (DB) schemes still hold at least some member records non-electronically; and only 4 per cent of DC schemes and 9 per cent of DB schemes have started digitising the information they hold in preparation for pensions dashboards. In addition, only 37 per cent of DC and DB schemes have discussed pensions dashboards at their scheme's trustee board meeting, with a similar proportion having engaged with their administrator about their scheme's data.

New powers will be given to the Regulator to issue compliance notices and penalties to trustees if they fail to comply with pensions dashboards requirements. Action may also be taken against third parties such as administrators, integrated service providers, and employers, where they are found to be the cause of non-compliance. The *Pensions Dashboards (Prohibition of Indemnification) Bill*, a Private Member's Bill brought forward by Mary Robinson MP, with the support of the Government, would forbid trustees from reimbursing themselves from scheme assets if they are fined for dashboards compliance failures, making it a criminal offence (punishable by up to two years in jail and an unlimited fine, in the worst cases) to try.[9] The Bill had its Second Reading in the House of Commons on 15 July 2022.

Updated guidance is planned for publication later this year to reflect the final Regulations, and the standards currently being developed by the Money and Pensions Service (MaPS). It is anticipated that the Regulator's guidance will evolve over time to reflect the industry's experience with pensions dashboards.

Time is of the essence for trustees and scheme managers to ensure their schemes can meet the statutory deadlines. Given that the first pension schemes are required to connect to dashboards as early as June 2023, and it is anticipated that it could take schemes at least 12 to 18 months to prepare for joining, we welcome the publication of the connection checklist to guide trustees through the process and expedite connection.

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[5] <www.pensionsdashboardsprogramme.org.uk/wp-content/uploads/2022/07/PDP-Standards-condoc.pdf>.
[6] <www.thepensionsregulator.gov.uk/en/media-hub/press-releases/2022-press-releases/trustees-warned-be-prepared-your-pensions-dashboards-deadline-is-coming>.
[7] <www.thepensionsregulator.gov.uk/en/trustees/contributions-data-and-transfers/dashboards-guidance>.
[8] See preceding article, *DWP Tweaks Dashboards Regulations Based on Consultation Feedback*.
[9] <bills.parliament.uk/bills/3215>.

Authorities pour oil on troubled transfer waters

The Department for Work and Pensions (DWP) and the Pensions Regulator have made a joint statement about the policy behind November 2021's *Conditions for Transfers Regulations*.[10] Their statement was issued in response to accusations that some pension providers have '*taken the opportunity to misuse recent legislation*'.[11] The Regulator has also revised its guidance on the matter.[12]

Transfer conditions

The Regulations imposed new conditions upon the statutory right to transfer, effective from 30 November 2021, in a bid to curb the loss of pension rights to fraud. In broad summary, the legislation allows transfers to proceed *if* the transferring trustees are satisfied either that the receiving scheme is of a prescribed, low-risk type (for example a public sector scheme or authorized master trust), or that the circumstances of the member's application raise no 'red flags' indicative of a scam (for example, if the member felt pressured into transferring). There are also a number of lower-tier 'amber flags' that, if raised, will halt the transfer only if the member fails to participate in a Money and Pensions Service guidance session.

Some of the 'flagged' features have been criticized for being overly broad in their reach. The most commonly cited problem is with the amber flag for cases in which '*there are any overseas investments included in the receiving scheme*'—where the phrase '*included in*' covers both the investments that would be made using the transferring member's funds, *and* the assets already held in connection with existing members.

The recent contretemps seems primarily concerned with a different flag, which is exhibited if trustees conclude that '*the member has been offered an incentive to make the transfer*'. That is a red flag, and as such prevents a statutory transfer from proceeding (unless the destination scheme is in the low-risk category recognized by the Regulations). The legislative examples of incentives include offers of free pension reviews, early access to pension savings, and '*cashback*'; however, the list is not exhaustive, so trustees may be obliged to exercise their judgement in other cases. It has become an issue because some pension providers use marketing initiatives such as reward or referral programmes. One such firm, which offers pension savers a means to consolidate their holdings into one vehicle and manage them online, is reported to have written to the DWP accusing other organizations of abusing the legislation to justify transfer delays.[13]

Statement & guidance

The joint statement from the DWP and the Pensions Regulator, in response to the kerfuffle, says that, '*The regulations are not intended to impose additional burdens on schemes or administrators, or to impact on standard business practices.*' However, the DWP is considering the need for changes to the legislation, and will publish its conclusions in a report that is due by May 2023. Trustees and scheme administrators are encouraged to contribute their opinions on the subject.

Meanwhile, the Regulator has revised its guidance on *Dealing with Transfer Requests*. It now says, for example, that some incentives '*could be considered normal industry practices.*' Both the statement and revised guidance highlight the possibility of trustees exercising their discretion (where such power is bestowed upon them by the scheme rules) to allow transfers to proceed when they conclude that, although a red flag has blocked the statutory transfer route, there is low risk of a scam.

It seems to us that a more charitable interpretation of the response to the new transfer conditions is that, rather than acting in bad faith, providers and scheme administrators have been understandably wary of choosing a 'purposive' interpretation of the law over the ordinary meanings of words. That is, properly, a job for the courts.

Better yet, Parliament and the Government should ensure that the legislation is consistent with policy and does not create dilemmas for those implementing it. The DWP appears to recognize that, hence the reference to its 18-monthly review of the Regulations. In the meantime, the statement and guidance may provide some reassurance to trustees who are more inclined to go boldy, but the current state of affairs remains unsatisfactory. Incentives that are 'considered normal industry practices' are definitionally still incentives, and the call for trustees to consider using discretionary powers to make extra-statutory transfers is a tacit admission that the legislation is currently sub-optimal.

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[10] <www.thepensionsregulator.gov.uk/en/media-hub/press-releases/2022-press-releases/dwp-and-tpr-joint-statement-on-transfer-regulations>.

[11] <www.professionalpensions.com/news/4052406/b-ce-hits-pensionbee-transfer-abuse-claims>.

[12] *Dealing with Transfer Requests* <www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/administration-detailed-guidance/dealing-with-transfer-requests>.

[13]

Considering the 'S' in ESG

The Department for Work and Pensions (DWP) has reported on the outcome of its March 2021 call for evidence about the 'S' in ESG: social factors.[14] A new taskforce led by the Pensions Minister, Guy Opperman, will seek ways to encourage trustees to focus more on social factors and take them as seriously as environmental ones.

The pensions investment rules were revised in 2019, requiring trustees to have policies on '*financially material considerations*' including environmental, social and governance (ESG) issues. Since then, the primary focus of attention has been on environmental factors, particularly climate change. In March 2021 the DWP called for evidence on trustees' current policies and practices in relation to social factors, specifically how they understand and integrate them into their investment and stewardship activities.[15]

The Government's response highlights that most schemes do not have standalone policies on social risks and opportunities as part of their investment strategies. A commonly stated barrier was the lack of relevant data. The DWP says that it is for trustees to decide how to factor financially material social risks and opportunities into their activities: they could have an integrated approach to ESG or a standalone social-factors policy.

To assist trustees in addressing the social element in ESG considerations, the Government is to establish a minister-led taskforce intended to help schemes identify reliable data sources and resources. It hopes that this will contribute towards the development of wider principles, standards and metrics.

PPF announces plans for levy redesign

The Pension Protection Fund (PPF) has published the emerging conclusions from its long-term funding strategy review, due to conclude this autumn.[16] Its expectation is that the PPF levy will meaningfully reduce over the coming years and that the overall levy system will be made simpler and more flexible.

This announcement follows the publication of the PPF's 2021/22 Annual Report and Accounts, which reports record funding levels.[17] As a result of strong investment performance and low claims, the Fund is more buoyant than it has ever been before. Aggregate income on investments now exceeds the total levy collected, and this gap is expected to further widen over time. In addition, the levy income received to date broadly covers the amount paid out in claims.

In light of this, and in order to maintain the PPF's current financial resilience, some limited investment risk will continue to be taken for longer than originally intended, and the levy will be reduced sooner than previously envisaged in order to reduce the reliance on levy payers. To support these objectives, a full levy system redesign is also planned. A more stable, transparent, and predictable levy system is proposed based on two key objectives:

- Flexibility—the levy will be significantly lower than it is currently, but the capability to raise it, if needed, will be retained; and,
- Simplicity—the level of sophistication, developed over time to reflect the many different circumstances of individual schemes and employers, will be reduced as the overall levy amount reduces.

These changes reflect the fact that claims arising are more easily absorbed as the Fund grows in size, with less reliance placed on the levy to meet the outgoing payments.

A consultation on the proposed levy rules for 2023-24 is currently planned for this autumn. The target levy collection (levy estimate) for next year will also be announced around this time.

We welcome the PPF's plans to review the levy in light of its improved financial position and to better reflect the future economic outlook. Reduction of the levy could deliver better value for money to schemes but the security of members' benefits should be at the heart of any changes proposed.

[14] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1091035/government-response-to-dwp-social-call-for-evidence.pdf>.
[15] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/972325/consideration-of-social-risks-and-opportunities-by-occupational-pension-schemes.pdf>.
[16] <www.ppf.co.uk/blog-posts/looking-at-future-funding-approach>.
[17] <www.ppf.co.uk/annual-report>.

HMRC newsletters: July 2022

Her Majesty's Revenue and Customs (HMRC) has published *Pension Schemes Newsletter 141*, which summarizes the pensions-related contents of the draft *Finance Bill 2022/23* legislation.[18]

The Government is making tweaks to the tax legislation to ensure that collective money purchase benefits and refunds from the Dormant Assets Scheme are properly treated, and to make HMRC responsible for the top ups that will be paid to non-taxpayers in net-pay-arrangement schemes, with effect from tax year 2024/25.

The Newsletter also includes some statistics on tax refunds connected with money purchase 'pensions freedoms' payments, and on transfers to qualifying recognized overseas pension schemes (QROPS).

[18] <www.gov.uk/government/publications/pension-schemes-newsletter-141-july-2022/newsletter-141-july-2022>.

And Finally…

There is a saying, misattributed to Abraham Lincoln, that '*the man who is his own lawyer has a fool for his client*'.[19] *AF* wouldn't go so far as to call the claimant in *Hamill v Lloyds Banking Group Pension Trustees*[20] a fool, but he certainly made some ill-advised decisions, one of which was indeed to pursue his case as a 'litigant in person' (a legal term for those who represent themselves in court, rather than the alternative to remote suing), thereby passing up an opportunity for an independent view on the strength (or otherwise) of his case. It's unclear whether he was ultimately required to pay some part of the other side's legal costs.

The chap in question was, in March 2009, briefly led to believe that he could claim his guaranteed minimum pension (GMP) at age 60. The administrator quickly realized its mistake and corrected his pensionable age to 65. However, as the judge explains it, '*The claimant was convinced (and remains convinced) that he was the victim of what he describes as criminal deception and corruption*', and '*From that time on… pursued a tenacious campaign to get what he believed to be his due.*' He first went through the scheme's internal dispute resolution procedure, then complained to the Pensions Ombudsman, without satisfaction.

The court case was launched four-and-a-half years after the Ombudsman rejected his complaint, though not as an appeal against that determination. According to the judge, Mr H '*spent the intervening time researching the law*'. This is the point in the court report at which *AF* had to cover the floor with paper towels to soak up the despair that began leaking out of the page.

It seems that '*The claim form was, in spite of the claimant's best efforts, wholly unintelligible.*' Despite making allowances for the claimant's status as a legal layperson, the judge found himself '*struggling to rescue from the distracting clutter of his sustained invective any reasonably arguable point.*' The Court was sent a '*large number of emails … much of the content of which is devoted to the task of energetically denigrating most, if not all, of the judges, court staff and other parties who have been involved*' (although the judge takes pains to note that the litigant was '*scrupulously respectful to this court throughout his oral representation and… behaved with all due courtesy to* [the Trustees' lawyer]').

It's possible that the claimant, who was '*prone to rant*', and whose '*enthusiasm for his cause led him badly astray in his written contributions*', may be a graduate of the Donald J Trump School of Writing. Indeed, the following observation by the judge might easily have been written about many (any?) of The Donald's infamous Twitter *oeuvre*:

> '*I can think of no submissions which are strengthened by the unrestrained deployment of uppercase letters, exclamation marks and baseless ad hominem attacks on those who disagree with the views of the author.*'

Ultimately, Mr H's passionate efforts availed him naught. Many observers of the American political scene will no doubt be hoping that the same is true of Mr Trump's 2024 presidential run…

[19] <quoteinvestigator.com/2019/07/30/lawyer/>.
[20] [2022] EWHC 900 (QB).

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