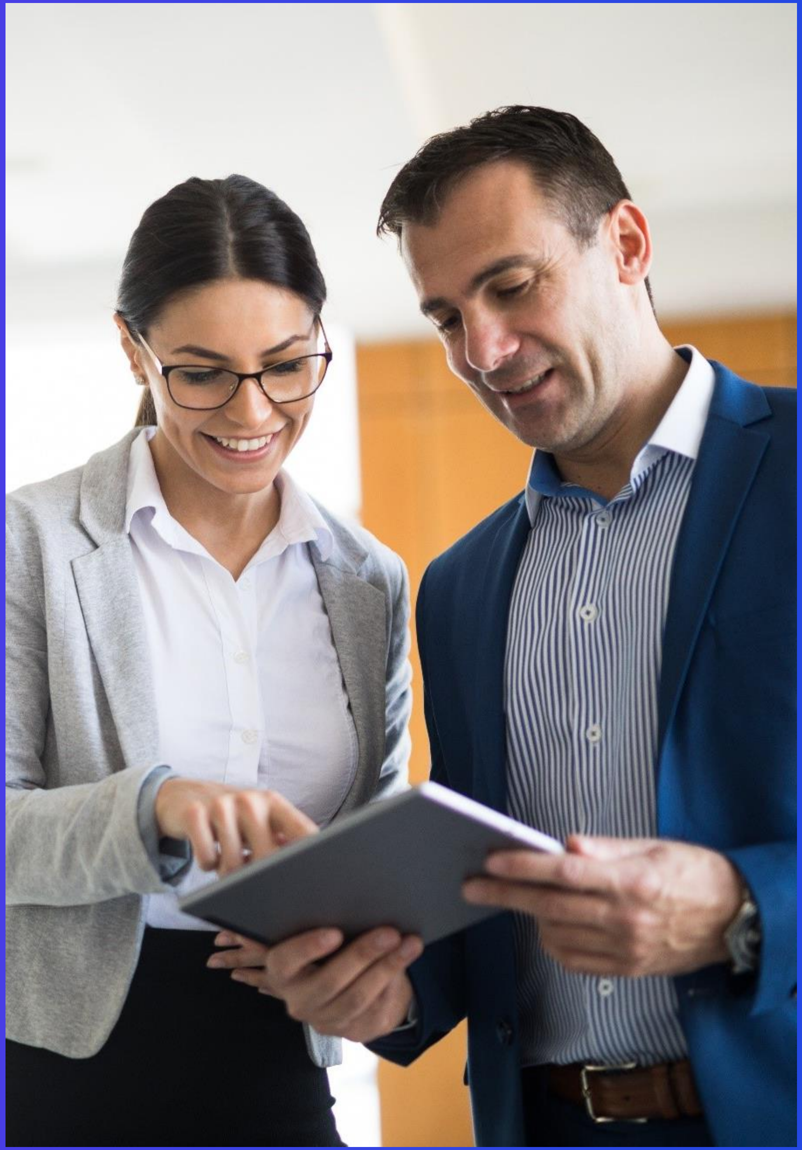
Pensions accounting, assurance and regulatory round-up



Private sector occupational pension schemes

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Winter 2024

Introduction

Welcome to the most recent edition of our Pensions accounting, assurance and regulatory round-up for private sector occupational pension schemes. This update covers a range of topics and considers developments from the Pensions Regulator (“TPR”), the Department for Work and Pensions (“DWP”) and the wider pensions industry.

If you have any queries or would like to discuss any of the matters herein further, please do get in touch with your usual contact at KPMG, Sarah or Anne.

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At time of writing (26 February 2024) all articles are up to date.

Executive Summary

FRC: FRED 82 (proposed revisions to FRS102)

A high-level view of the impact on pension schemes of the Financial Reporting Council's ("FRC") proposals.

Schedules of Contributions / Payment Schedules: drafting issues

A quick look at the requirements for, and potential pitfalls in drafting, a Schedule.

Amendments to scheme provisions

Two recent cases highlight the complexities of amending scheme provisions.

General Code

A look at the content of TPR's long awaited new General Code.

TPR news

A round up of some of TPR's recent activity.

The revised Funding and Investment Strategy Regulations

Highlights of the changes made in the newly issued Funding and Investment Strategy Regulations.

Defined Contribution ("DC") activity and reminders

Updated insights including TPR on trends in the DC market and the DWPs review of Master Trusts ("MT").

ESG Essentials

A summary of headlines over the period, to keep schemes abreast of new developments and announcements.

Climate Change Governance and Reporting: Understand and increase confidence in disclosures

A brief summary of the benefits of obtaining assurance over climate disclosures.

Call for Evidence conclusions and Superfunds update

The Call for Evidence summarized proposed actions and reference to latest consultation.

Ending the proliferation of small pots: the multiple default consolidator model

A summary of the latest proposals on consolidation of small pots.

Decumulation: Helping savers understand their pension choices at the point of access

A summary of proposals requiring all schemes to offer a decumulation provision.

News in Brief

FRC: FRED 82 (proposed revisions to FRS102)

The Financial Reporting Standard ("FRS") appropriate to pension schemes in the UK is FRS102. The Pension Schemes Statement of Recommended Practice ("SORP"), giving further practical application to pension schemes, flows from FRS102.

FRSs are subject to periodic reviews (every 5 years). The second review of FRS102 is underway. The Financial Reporting Council ("FRC") issued Financial Reporting Exposure Draft ("FRED") 82 outlining proposed changes to FRS102 with a deadline for comments of 30 April 2023. The revised FRS102 was originally expected to be effective for accounting periods starting on / after 1 January 2025. However, a recent project update reports that the final amendments will be issued in the first half of 2024 and the effective date will not be earlier than 1 January 2026. The FRC is currently considering the 54 responses received to the FRED.

The changes have been precipitated by changes to international standards, International Accounting Standards Board ("IASB") proposals in relation to smaller entities, feedback and other developments in reporting. Principal amendments proposed relate to revenue and lease accounting. Other incremental changes are also proposed. Minor amendments are proposed to Chapter 34 of FRS102 in respect of Retirement Benefit Plans.

The Pensions Research Accountants Group ("PRAG") SORP Working Party will review the proposed amendments to develop a revised SORP looking at the proposed revisions to FRS102 and other pension specific matters. The effective date of the revised SORP is expected to be in line with the effective date of the revised FRS102.

An update to the SORP opens up the possibility of wider discussion on the development and purpose of scheme annual reporting. The proposed revised SORP will be subject to a consultation process. We will keep you updated as to the progress of the project and opportunities to respond on the consultation draft.

Schedules of Contributions / Payment Schedules: drafting issues

Under the Occupational Pension Schemes (Requirement to Obtain Audited Accounts and a Statement from the Auditor) Regulations 1996, trustees are required to obtain an auditor's statement as to whether or not contributions have in all material respects been paid at least in accordance with the schedule of contributions or payment schedule.

A schedule of contributions prepared for a hybrid or defined benefit ("DB") scheme must show the rates and due dates of all contributions (other than voluntary contributions) by or on behalf of the employer and the active members of the scheme together with any other contributions made to the scheme to satisfy other liabilities (such as for administrative expenses). The schedule must be signed by the trustees, allow for signature by the employer and be certified by the scheme actuary.

DC schemes must have a payment schedule in place. This serves a similar function to a schedule of contributions but can be prepared for a longer period and does not need actuarial certification.

In the majority of cases, the drafting of a schedule of contributions / payment schedule does not cause a problem from an audit point of view. However, recent cases have shed light on a number of areas which give rise to complications, the key issues highlighted being:

- The inclusion on a schedule of payments by the employer to escrow or other contingency arrangements which sit outside the pension fund. The inclusion of these amounts on the schedule brings them within the scope of the auditor's statement on contributions, as per the requirements of the Audited Accounts Regulations. Care then needs to be taken on the presentation of these amounts in the summary of contributions as the assets received will not be within the balances included in the scheme financial statements.
- Additional payments referred to in the schedule of contributions but paid under a separate arrangement (such as an arrangement funding a buy-in for example) where the amount is paid into the scheme directly will come within the auditor's statement and be included within the summary of contributions.
- An overly complex contribution structure will result in additional audit time and costs. References, for example, to triggers in the employer's financial position will result in the need for the scheme auditor to seek additional comfort on the contribution levels received by the scheme.
- A schedule of contributions becomes effective only from the date of certification and cannot be backdated to take effect earlier. The scheme auditor will only pick up a new schedule at the certification date and will not take account of any backdated period. If contributions over this backdated period have been reduced (following the revised schedule) then this could lead to a modification of the auditor's statement. Any overpayment made (as against the schedule in place up until the revised schedule is certified) will not lead to modification of the auditor's statement as the auditor is required to report on whether contributions have in all material respects been paid at least in accordance with the schedule. An adjustment made to contributions within the schedule to be received after the certification date reflecting a changed contribution rate for an earlier period does not cause any issue as the auditor will report against the new revised schedule.
- In cases where contributions are defined as a percentage of pensionable salary, the definition of pensionable salary should be aligned with the definition in scheme documentation.
- Any schedule should be drafted taking practical considerations such as the operation of the employer payroll (which may be run on a 13 4-weekly basis) into account.
- As a general rule, keeping the schedule as clear and unambiguous as possible is to be advised. It is recommended that trustees share a draft of any new schedule with the scheme auditor before it is finalised.

Amendments to scheme provisions

Two recent court cases have shed light on the validity of changes made to scheme provisions.

In June 2023, the High Court handed down a decision in the case of Virgin Media Limited v NTL Pension Trustees II Limited and others relating to the validity of certain historical pension changes. This case may have implications for other defined benefit schemes in the UK.

The case focuses on the implications of failing to obtain actuarial confirmation (as required by s37 of the Pension Schemes Act 1993) when making an amendment to the deed and rules affecting section 9(2B) rights and, consequently, whether the scheme would continue to satisfy the requirements for those rights. Section 9(2B) rights refer to the reference scheme test level of benefits to be met by schemes contracted-out on a salary-related basis over the period from 6 April 1997 to 6 April 2016.

The Virgin Media case related to the validity of a trust deed and rules change from 1999, for which no Section 37 Confirmation had been located. There are three parts to the court's decision:

- **Issue 1:** What was the consequence of failing to obtain actuarial confirmation?
  The court decided that the failure of a salary-related contracted-out scheme to obtain an actuarial confirmation required by Section 37 meant that the amendment was invalid and void.
- **Issue 2:** Was the invalidity limited to changes in relation to rights attributable to service before the date of the amendment (past service rights) or did it also apply in relation to rights attributable to service after that date (future service rights)?
  The court decided that any change in relation to Section 9(2B) rights would be invalid and void; the invalidity was not limited to changes to past service rights.
- **Issue 3:** Was the invalidity limited to adverse alterations to Section 9(2B) rights or did it apply in relation to all alterations to such rights?
  The court decided that the requirement for actuarial confirmation applied to all amendments to Section 9(2B) rights and not just those which would or might adversely affect Section 9(2B) rights. All changes to Section 9(2B) rights, even where the changes could only improve such rights, are therefore invalid if no actuarial confirmation was obtained.

The judgement is potentially relevant for schemes that:

a) were contracted-out on a salary-related basis between 6 April 1997 and 5 April 2016, and

b) made changes to member benefits in that period that could have impacted Section 9(2B) rights.

The court ruling is fairly wide ranging, in that it is possible that both past service and future service changes are invalid, even if those changes could not adversely affect Section 9(2B) rights. Schemes may wish to wait for the outcome of any appeal before concluding whether the current ruling impacts them or not.

Trustees of impacted schemes may see auditors undertaking additional enquiries of management and review of legal and other documentation. Appropriate accounting and narrative disclosure in the scheme annual report and accounts will need to be dealt with on a case by case basis.

In a second and separate High Court case involving the BBC the court ruled that, under the relevant rule, changes to future service benefits and/or member contributions for active members could only be made when the trustee and employer agree and set conditions in the rule were satisfied. The BBC have been granted permission to appeal the decision.

The above cases highlight the complex issues which need to be considered when making changes to scheme provisions and the need for trustees to obtain expert advice and document decisions made.

General Code

TPR's General Code (the 'Code') was laid before Parliament on 10 January. Its effective date is 27 March 2024: some three years after the original draft was published.

The Code consolidates 10 out of the existing 16 Codes of Practice. It should be noted that 6 Codes remain outside this new 'supercode' and should be referred to separately where circumstances dictate.

A modular approach is taken, with 51 modules in total, facilitating easier update of individual topics. Modules are clear, short, and concise and helpful glossaries are included throughout.

Some modules contain what appear to be long lists of useful considerations, e.g. the Trustee Knowledge and Understanding module, though these will need to be tailored to the needs of each scheme.

Much of the content is familiar from TPR's existing codes. However, there are new areas (noted below) which trustees need to be aware of and follow up on.

Stewardship

The module reiterates requirements for reporting requirements and policies in relation to financially material Environmental, Social, and Corporate Governance ("ESG") considerations, voting and arrangements with asset managers. TPR's expectations are set out and include for example identifying rights (including voting rights) attached to investments and considering approach to voting and engagement.

Climate change

The module distinguishes between physical and transition risks and notes Task Force on Climate-related Financial Disclosures ("TCFD") reporting for schemes in scope. Trustees should 'talk to advisers and managers about how short and long term climate change risks and opportunities are built into their recommendations' and understand what is being done in relation to climate change risk within investments. The module notes that although schemes are not required to align to the Paris Agreement and other goals such as the UK's target of net zero by 2050, they may wish to assess progress towards these goals.

Cyber security

Trustees should reduce the risk of incidents and deal appropriately with any which do occur. Expected actions for assessing and managing cyber risk are noted, such as regular back-ups, policies on device use and on data. A cyber incident response plan should also be in place.

Risk Management

The Code includes a requirement for schemes requiring an Effective System of Governance ("ESOG" – see below) with 100+ members to have a risk management function. This is to be proportionate to the circumstances of the scheme and is addition to the Own Risk Assessment ("ORA" – see below).

Assurance on internal controls

Options are noted such as statutory audit (in relation to financial affairs), internal audit, assurance reporting by service providers and trustees' commissioning of their own assurance procedures and reporting.

Two key new areas will require more trustee consideration. These are the ESOG and the ORA.

ESOG

A new term for pension schemes in the UK, the ESOG includes all delegated functions. Features of an ESOG are described by the Code as:

'A system of governance will include anything that can reasonably be considered part of the operation of a pension scheme. Internal controls are a key feature of any system of governance.'

A proportionate approach can be taken taking the 'size, nature, scale and complexity' of the scheme into consideration.

The module refers to other areas of the Code which form part of the ESOG, including management of activities, such as the role of the governing body, meetings, remuneration policy; organisational structure, including appointment and role of the Chair and conflicts; investment matters, such as

General Code (cont.)

investment governance, decision making and monitoring, the Statement of Investment Principles (“SIP”), stewardship and climate change; and communications and disclosure covering general principles for member communications.

The ESOG should be reviewed every three years but this does not have to be done at a single point in time. Review may form part of the ORA. Trustees may wish to consider obtaining assurance.

One area specifically referred to in the ESOG module is the remuneration and fee policy. There is a requirement for a written remuneration policy, to be reviewed every three years. In a change from the draft General Code we saw in March 2021, there will be no requirement to publish the policy on a website.

ORA

Schemes requiring an ESOG with 100 members or more will need to undertake an ORA. The ORA considers how well the ESOG is working and how risks are being managed. Again, the principle of proportionality applies. TPR may view failure to complete an ORA as indicative of poor governance.

The first ORA must be carried out according to the timescales set out in the Regulations. This is likely to mean a date roughly two years into the future though, as there are other considerations within the Regulations, each scheme must assess this based on its own individual circumstances.

All areas covered by the ORA should be assessed. It is not necessary to review all aspects together but a whole ORA should be completed every three years (note this is a change from the one year timescale set out in the 2021 draft and now fits in with the 3 year requirement in the 2018 Regulations). A new assessment will be needed where there are new or updated elements and where there is a material change in the ESOG or risk profile of the scheme.

Trustees may need to enhance existing risk assessments to meet the requirements. The ORA could be a collection of existing documentation and may include assurance reporting from delegated functions.

Undertaking an ORA should be an iterative process; the results may be useful formulating processes or procedures and help trustees with prioritisation of required actions.

ORAs must be in writing, signed off by the Chair with documents supplied to all trustees. They should include the date of current and next review and detail regarding any interim reviews.

As an overview, an ORA should cover:

- ‘how the governing body has assessed the effectiveness of each of the policies and procedures covered;
- whether the governing body considers the operation of the policies and procedures to be effective and why’.

The ORA module of the Code then goes on to list the specific areas to be covered – regarding policies for the governing body, risk management, investment (with additional matters for DB schemes), administration and payment of benefits.

What can trustees be doing now?

Trustees need to plan ahead for the new requirements. They should:

- familiarise themselves with the requirements of the Code;
- identify the modules expected to form part of the ESOG now and ensure they are planning how to comply;
- consider new requirements, such as the remuneration policy;
- assess whether existing procedures meet the requirements for an ORA, collate documents which will form part of the ORA and identify gaps. The first ORA process may involve significant work and resource needed to complete this should be recognised and planned for; and
- ensure training and resource to meet the new requirements is anticipated and planned for.

TPR news

TPR has published a number of items since our last Round Up. Some items of news not covered in other articles are summarised here.

Key Priorities for TPR

At the Pensions and Lifetime Savings Association ("PLSA") annual conference, Nausicaa Delfas (CEO of TPR) gave a speech outlining the key priorities for TPR.

At a time of significant change, TPR and trustees can work together to enhance the experience for pension savers across the UK. The pensions landscape is moving away from thousands of small schemes, merging them to be larger, efficient, and well governed schemes.

TPR should focus on three things:

- Protecting savers' money
- Enhancing the system
- Supporting innovation in savers' interests

Protecting savers' money

TPR's job is to ensure that those in charge of running pension schemes, are doing so in the interest of the savers and will enforce their powers if there is poor practice or trustees are not meeting TPR's expectations. It states that 'too many savers are in sub-scale and sub-par schemes'. The impending Value For Money Framework will expose comparable, standardised data disclosures, highlighting value rather than cost alone. It is hoped this will facilitate adequate competition, allowing good schemes to improve, and poorly performing schemes to depart from the market. Trustees will need to consider whether they should consolidate their scheme to offer better member outcomes.

For DB schemes, it is anticipated that the emerging Superfunds market will give members of weaker DB schemes greater protection by providing more variety of consolidation options, resulting in an enhanced chance of members receiving their promised benefits. TPR welcomes innovation whilst ensuring that its processes do not create barriers in this area and protect members. It is hoped that there will be more options for consolidation in the future.

Enhancing the system

Quality of trusteeship will be another key priority. Trustees are expected to be representatives of the scheme members and should be willing to ask tough questions to scheme advisors and to offer their members appropriate saving options. TPR has outlined its expectations of trustees in its General Code. Read our General Code article here. TPR will be ramping up its challenges on trustees to ensure decisions are being made in savers' interests.

Supporting innovation

The pensions market is expected to pioneer to meet the needs of a variety of savers with different retirement needs, particularly for savers at the point of retirement. TPR, together with trustees, will need to help navigate choices available between suitable options which offer a default option to those who cannot make a decision. Multi-employer Collective DC schemes are being explored as an option.

TPR will also evolve to become more assertive in changing behaviours, anticipate threats and opportunities through a new digital and data strategy and rethink its regulatory approach including engaging with a broader range of advisers.

TPR will work with the pensions industry, Government and other regulatory partners to achieve its aims.

Occupational defined benefit (DB) landscape in the UK 2023

TPR published its analysis of the occupational DB landscape for 2023 in February. The report highlights changes in the profile of UK DB and hybrid schemes, looking at various scheme statistics.

Headline themes emerge. The number of DB and hybrid schemes has continued to reduce, down from 5,378 in 2022 and standing at 5,297 in 2023. The proportion closed to future accrual

TPR news (cont.)

(excluding those in wind up) has increased by 2% to 72%. Improvements in scheme funding have been identified with the number fully funded on a technical provisions basis going up from 2,565 to 3,620. The aggregate deficit of all schemes in deficit has more than halved to £27.673bn.

Cyber security principles for pension schemes

In December, TPR updated its Cyber security guidance for pension schemes. TPR is encouraging voluntary reporting of significant cyber incidents as soon as possible after the event. However, the guidance clarifies that such reporting does not relieve trustees of other applicable or appropriate reporting obligations.

The guidance outlines the nature of cyber risk and reminds trustees of their overall responsibility for scheme information. Trustees are responsible for understanding risk, ensuring there are controls within delegated functions and managing any incidents. Risk reviews should be undertaken at least annually and records kept. Appropriate advice should be sought.

Management of risk will mean working with others and ensuring that they have appropriate controls, possibly demonstrated by specialist accreditation such as Cyber Essentials. Scoping of any testing, accreditation and insurance should be considered and metrics selected for monitoring of any third-party suppliers. Reporting should be received covering existing and upcoming cyber threats. Cyber security should also be a key consideration in tender situations.

Key points to consider in understanding risk are also laid out. These include understanding the scheme's 'cyber footprint' across all parties connected with the scheme, the scheme's vulnerabilities and the potential impact of any breaches.

Trustees should ensure that delegated functions have proportionate controls in place to reduce the likelihood of, and detect, cyber incidents and to respond effectively. National Cyber Security Centre ("NCSC") guidance is referred to here. The guidance sets out TPRs expectations of controls which should be in place in relation to prevention covering staff engagement and training, data security and technical controls, highlighting the need to update software promptly.

The importance of monitoring, audit trails and early detection are discussed outlining the need for clear reporting processes and logging of any reports made.

Plans should be made for responding to any incident; the guidance cross refers to NCSC guidance on how to approach this. Regular testing and updating of plans is also noted together with ensuring trustees have the ability to deal with incidents, possibly through using a third party provider. Incidents should be documented with post-incident review, monitoring or actions considered.

Incident response plans for a range of scenarios should be tested. Trustees also need to understand plans operated by external parties who look after scheme data and work towards bringing core schemes services back online as soon as possible.

Trustees are also responsible for communicating to members and should keep them updated during any protracted investigations.

TPR expectations on Mergers and Acquisitions ("M&A")

In December 2023, Nausicaa Delfas gave a speech at the UK Finance Corporate Finance Committee dinner outlining TPR's supervisory expectations and approach relating to protection of pension schemes during merger and acquisition transactions, noting that "…as a regulator when it comes to M&A activity, we are not here to prevent transactions – we are here to make sure savers' interests are protected."

For a number of reasons, DB schemes are currently very well-funded – this improved funding position of pension schemes could make businesses more appealing, resulting in more M&A activity. TPR wants to ensure that the pension schemes are treated fairly alongside other creditors and that the scheme(s) do not suffer any disadvantages as a result of M&A activity.

TPR expects previous and new management teams from the businesses to provide prompt support to the trustees to ensure a robust funding plan for the pension scheme(s) and to ensure any potential harm to the pension scheme is mitigated. TPR will consider not doing so as avoidance and has avoidance powers including Financial Support Directions, Contribution Notices and criminal powers. TPR suggests that trustees reach out for assessment of proposed transactions and

TPR news (cont.)

would be unlikely to intervene if trustees are receiving the information needed, have appropriate support and are acting in members' interests. Additionally, corporates may wish to seek a clearance statement from TPR to provide assurance that TPR will not use their Contribution Notice and Financial Support Direction powers in relation to any given proposed transaction.

Developments in the defined benefit alternative arrangements market

In a November blog, TPR announced that it was working with industry looking into alternative defined benefit scheme funding arrangements.

Capital Backed Journey Plans ("CBJP") have been of recent interest. Such plans allow, on agreed terms, investment of the scheme assets in a higher return portfolio which is being supported by additional capital from a third party.

TPR would support, after rigorous review, such a proposal if it resulted in members receiving appropriate benefits above those provided by the Pension Protection Fund ("PPF") (the fallback option for distressed employers). CBJPs would be assessed against TPR's superfund guidance. TPR supports innovation and consider that CBJPs may be a positive step for some schemes.

TPR expects early engagement with the employer, TPR and PPF, consideration of the balance of risk and capital injection, sufficient knowledge and skill to assess the proposals and be free of conflicts, consulting with advisers if appropriate.

TPR notes trustees should 'engage…at the earliest opportunity if you are considering a CBJP to ensure you are meeting our expectations to protect savers'.

TPR private markets investment guidance

Continuing the theme of pension scheme investment in alternative and illiquid assets, TPR issued guidance on 24 January on private markets investment.

The guidance notes that investment in 'new and innovative opportunities' may be of value and in the best interests of members. They may have a role to play as part of a diversified portfolio provided the appropriate governance is put in place. Appropriate advice should be taken.

Trustees are urged to consider consolidation or alterative governance models if they are unable to take advantage of the potential value of such investments. Trustees need to assess, amongst other factors, whether they have appropriate knowledge and understanding, sufficient governance budget to seek advice and advisers with the right skills. The key features of an investment will need to be understood.

Time will need to be allocated to reviewing these assets; trustees will need to ensure they have appropriate governance structures in place together with the right service providers.

The guidance takes a close look at investment in private equity, private debt, private real estate and infrastructure and natural resources and notes that some of these opportunities may not be available through public markets. Trustees are encouraged to look at the full range of investments available, consider concentration risk and diversification and, after advice, invest in members' best interests.

Access to investments should also be considered, including the use of innovative structures. Again, advice should be sought on this aspect. A combination of public and private may be optimal in building a scheme portfolio.

Cashflow requirements and valuations will be further considerations. Trustees need to consider whether they have sufficient liquidity within their strategy to meet cashflow requirements while still meeting performance targets. The approach taken to investment valuation and its sensitivity should be understood.

Opportunities and risks are highlighted. Opportunities include higher returns, access to new opportunities and sources of income while risks include illiquidity, additional governance needs and variation in returns over time.

Specific considerations for DB and DC schemes are noted.

Trustees are reminded of their legal duties. Investment must always be in the best interests of scheme members, assets should be invested predominantly in vehicles traded on regulated markets and be appropriately diversified. Investments not publicly traded should be kept to a prudent level. Trustees will need to disclose policies on illiquid assets in their Statement of Investment Principles and asset class allocation in their Chair's Statement.

The revised Funding and Investment Strategy Regulations

The Government has published the Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2024 which will come into force from 6 April 2024. This is a complex area with requirements stemming from a number of sources which should be referred to for a full picture; this article focuses solely on key changes to the newly published Regulations.

The new provisions will impact actuarial valuations with effective dates on or after 22 September 2024. The Regulations are relatively brief, amounting to only 15 pages in total, with much of the detail still to be added by TPR's anticipated Funding Code. The Regulations set out a framework to facilitate the requirement of the 2021 Act that trustees must 'determine… a strategy for ensuring that pensions and other benefits… can be provided over the long term'. Trustees must plan to reach full funding on a low dependency basis by a targeted 'relevant' date at or before scheme maturity.

The Ministerial Foreword states that the provisions 'strike a fair and lasting balance between security for members and affordability for sponsoring employers as the economic context evolves'. Changes have been incorporated to allow more flexibility and risk taking where it is supportable, while embedding good practice to ensure members benefits remain secure. Recovery plans must now consider the impact of the proposed funding on the sustainable growth of the employer.

This article will take a high level look at some of the key changes.

Scheme maturity

The regulations support a duration of liabilities measure for scheme maturity. Concerns were raised about the volatility of this measure. A revision has been made to set a fixed date, 31 March 2023, to base economic assumptions on a low dependency funding basis in maturity calculations. TPR's Code will set out the duration when the scheme reaches significant maturity.

Relevant date

The relevant date is the date at which schemes expect to meet their long term target. Revisions to the regs clarify that for schemes which have already reached significant maturity, the relevant date is the date of the valuation and also that TPR can differentiate between dates of significant maturity depending on scheme type (such as Cash Balance and certain hybrid schemes)

Open schemes

Responses indicated concern in that open schemes may be required to inappropriately de-risk. The Regulations now state that open schemes can allow for new entrants and future accrual in maturity calculations, subject to reasonable assumptions and employer covenant. This will allow schemes to take account of their slower journey to maturity.

Low dependency investment allocation

Whilst still intending to balance security and affordability, revisions have been made to clarify that schemes can allocate to a range of investments, other than bonds, beyond significant maturity and that the requirements for a low dependency investment allocation do not apply to any surplus funding.

Strength of employer covenant

The strength of employer covenant is defined as the 'financial ability of the employer, in relation to its legal obligations … to support the scheme', both in the immediate and longer term.

Risk along the journey plan

The journey plan forms part of the Funding and Investment Strategy. Revisions facilitate this, ensuring technical provisions are set out for the journey plan and low dependency funding basis at the relevant date. This does not impact trustees' power over investment decisions. Overall, more risk can be taken on when the scheme has a strong employer covenant and is further from its relevant date.

Level of detail: funding and investment strategy

The journey plan from the funding level at the date of the actuarial valuation to that at the relevant date will need to be described including discount rates and other assumptions and how these are expected to change.

The revised Funding and Investment Strategy Regulations (cont.)

Statement of Strategy

The finalised regulations amend the level of detail required to make disclosure more practical and reduce administrative burden. TPR will have discretion in how much information is requested, requirements for evidence supporting certain disclosures have been removed and a requirement to submit a summary of scheme valuations added to the statement of strategy.

What next…?

As noted above, more detail will emerge with the publication of TPR's final Funding Code. Updated Fast Track parameters will also be published aiming to provide a route to compliance with minimal regulatory intervention. As noted earlier, this is a complex area and scheme trustees should consult with their actuarial advisers on the implications for their schemes.

We await further developments later this year…

DC activity and reminders

Since our last edition of Round-Up, we have seen further activity in relation to DC schemes.

DC issues

November 23 saw the DWP publish new analysis ‘Trends in the Defined Contribution trust-based pensions market’. The analysis looks at the changes to the DC landscape and the growing role of Master Trusts (“MT”s) and was used to inform the Master Trust Review (see below).

DWP’s analysis takes a high level view of the DC landscape using estimates to project what the future might look like with the aim of demonstrating market consolidation and benefits to members. The document notes ‘there is evidence that schemes operating at a very large scale… are likely to realise scale efficiencies in future, and can be better placed… to create diversified investment strategies… with the associated potential benefits’.

DWP refer to TPR data noting that much of the growth in assets of trust-based schemes has come from MTs, quoting a figure of 75% of trust-based assets held by just over 30 MTs and 95% of all active memberships being in MTs. The MT market itself is highly concentrated with 80% of memberships within 5 schemes. Aside of MTs, the number of DC schemes has fallen and if this trend continues, could drop to only 500 by 2030 (from 3,700 in 2012).

A series of assumptions sit behind projections of how the market will behave, including asset and saver growth rates (in general and in MTs). DWP have assessed their model under various scenarios for sensitivity. Under their ‘central estimate’ (i.e. between the upper and lower bounds), DWP estimate that the trust-based market could grow from £130bn in 2023 to £420bn in 2030 with MTs contributing significantly to this. Further, 80% of members could be in the largest 5 MTs and almost 80% being in schemes greater than £30bn.

Benefits of consolidation for members are noted as economies of scale, reductions in member charges, and greater investment opportunities / diversification and improved governance though evidence linking size to returns is weaker and DWP will research this further. The concept of an ‘optimal size’ to maximise any benefits of consolidation is noted. Benefits could be manifold; the analysis concludes that ‘an average earner could have £3,000 more in their pension pot as a result of moving into a large MT’.

Master Trusts (MT)

The DWP also published their review (undertaken with TPR) of the MT regime in November. The DWP conclude that the MT market will continue to grow and become more concentrated. Consolidation into good quality MTs is seen as positive in targeting good member outcomes. DWP emphasise that they are ‘putting savers and value for money at the heart of … policy’ and focussing on value rather than cost alone. It is anticipated that value will be gained through investment strategies generating returns from a diverse range of assets including innovative UK opportunities. We will see a ‘more influential approach’ from TPR with enhanced supervision of investment governance.

The size of MTs means that they can benefit from economies of scale, invest in a wider range of assets (including productive finance) and improve member services. The review highlights that MTs will be key to delivery of the Government’s current proposed reforms; key aspects are:

- At the time of publication, 9 MTs were signatories to the Mansion House compact, looking to invest 5% of assets in unlisted equities.
- MTs are likely to be default consolidators under the proposed ‘small pots’ consolidation regime (see article).
- MTs may be attractive to those now saving as a result of the extension to Automatic Enrolment.
- Schemes winding up as a result of ‘value for member’ assessments or under the proposed Value for Money (“VfM”) framework may look to MTs.
- MTs will need to provide decumulation options under new proposals (see article).
- DWP see a role for MTs in developing the Collective Defined Contribution (“CDC”) market.

Although MTs are expected to ensure they meet VfM requirements, they should continuously improve. TPR will aim to improve outcomes within MTs which will include enhanced supervision of investment governance.

DC activity and reminders (cont.)

Consolidation has also led to growth in MTs. They will become increasingly attractive to employers as, per the DWP ' they use this scale to develop sophisticated investment strategies, with access to the best expertise, trusteeship and are able to able to use economies of scale to operate at a low cost…… which we believe can serve in members' best interests'.

DWP conclude overall that the current regime is 'fit for purpose', though there are some actions to be taken. Actions noted include, for TPR:

- to adopt a more collaborative supervisory approach,
- to enhance investment data collected to identify strategies and trends, enabling challenge, and
- expecting an adequate level of investment expertise in trustee boards.

And for DWP:

- supporting TPR, including through legislation if needed,
- keeping the MT regime under consideration, and
- to work with TPR to identify risks arising from the size of schemes.

TPR's approach to supervision of the MT market will evolve. DWP is supportive of this as it helps 'to drive innovation which is member-centric and in savers' interests'.

Illiquids

In August, TPR updated its guidance to help DC schemes comply with new regulations designed to ensure they consider all the investment opportunities available to achieve the best value for savers. From 1 October 2023 trustees must state their policy on investing in illiquid assets in the Statement of Investment Principles for their scheme's default arrangements. Trustees are also required to disclose the asset class breakdown for each of their scheme's default arrangements in the Chair's Statement.

The requirement to state the trustees' policy on the default arrangements investing in illiquid assets in the default SIP takes effect from the first default SIP produced after 1 October 2023. The default SIP must be updated to include this policy by 1 October 2024 at the latest.

If the policy is for a default arrangement to invest in illiquid assets, the default SIP must, for that default arrangement, describe:

- the age profile of the members for whom investments will be held in illiquid assets
- whether the investments made in illiquid assets will be made directly in illiquid assets or via a collective investment scheme
- the types of illiquid investments that will be held
- why the policy is to invest in illiquid assets – including the advantages over other classes of assets
- whether there are plans to increase investment in illiquid assets in the future.

If the policy is for a default arrangement to not invest in illiquid assets, the default SIP must explain why, and whether there are any plans to invest in illiquid assets in the future.

The trustees must make the default SIP publicly available free of charge on a website.

Asset allocation

From the first scheme year ending after 1 October 2023, the annual Chair's Statement must disclose for each of the scheme's default arrangements the percentage of relevant scheme assets allocated to each of the following asset classes:

- cash
- corporate bonds, UK government bonds and foreign government bonds
- listed equity
- private equity

DC activity and reminders (cont.)

- infrastructure that provides or supports public services including water, gas and electricity networks, roads, telecommunications facilities, schools, hospitals, and prisons
- property/real estate (excluding property included under 'infrastructure')
- private debt/credit (excluding debt investments included under 'bonds')
- other assets.

DWP's Statutory Guidance explains these asset classes in more detail, with advice on presenting this information for different age cohorts, and further detail on sub-asset classes to help member understanding.

Performance-based fees

New regulations from 6 April 2023, have removed a regulatory barrier that may have hindered trustees from exploring investment in certain funds that came with performance fees. Trustees have the option to exclude specified performance-based fees from the list of charges falling within the regulatory charge cap limit of 0.75% per annum. Schemes must disclose any performance-based fees incurred in relation to each of their default arrangements, calculated as a percentage of the average value of the assets held in those defaults in their Chair's Statement. Trustees must then assess the extent to which these fees represent good value for members alongside other costs and charges.

Value for money

Ensuring value for money is a theme never far away when considering DC schemes. As part of the pensions measures covered in the Mansion House Speech, the DWP, the Financial Conduct Authority ("FCA") and TPR published their response to the joint consultation on a Value for Money Framework on 11 July 2023.

The new framework looks across the key elements of investment performance, costs and charges, and quality of services provided with key metrics, standards and data disclosures under this proposed framework, as well as proposals for the use of this data in comparisons and assessments of value for money.

The response to the consultation confirmed that plans for the new framework will go ahead, in phases, but requiring primary legislation and further industry consultation. No timetable has been given as yet.

ESG Essentials

There has been further activity relating to ESG themes. A selection of key issues is discussed below.

TPR blog on ESG

On 21 February, TPR published a blog encouraging trustees to consider how to develop their thinking around ESG risks and opportunities, noting that the 'goal is not disclosure for disclosure's sake but to encourage genuine change in how schemes operate'. Trustees are urged to continue to improve their understanding and ensure they have the right advisers to effect transition plans. Trustees may also consider early adopting Taskforce on Nature-related Financial Disclosures ("TNFD") reporting, building on lessons learned from TCFD reporting and collaboration with others in this area.

Institutional Investors Group on Climate Change ("IIGCC") Net Zero Voting Guidance

In January, the IIGCC issued net zero voting guidance with the aim of supporting asset owners, such as pension schemes, in developing net zero voting policies and practices.

The guidance notes that trustees must 'set their own strategies, policies and practices based on their own best interest and in compliance with any applicable illegal and regulatory requirements'.

Three principles are outlined for net zero voting. In summary these are that voting should align with trustees' net zero objectives and targets, it should communicate expectations regarding net zero and support net zero stewardship engagement and investment activities.

Engagement and stewardship play a key role in aligning climate goals. The guidance stresses the importance of voting as a mechanism to hold companies to account for their performance either highlighting poor performance or offering support for those who are taking appropriate actions. It goes on to discuss development of 'a voting approach that augments engagements, signals shareholder interests, and supports companies to deliver the rapid acceleration in decarbonisation required to halve emissions by 2030 and put the world on course for net zero by 2050 or sooner'.

The PLSA have also published their 2024 Stewardship and Voting Guidelines. This new edition includes content on recent events impacting engagement activities, a new section on social factors, topics such as cybersecurity, artificial intelligence and biodiversity and an extended summary on voting recommendations.

Sustainability Principles Charter

A sustainability principles charter covering the bulk annuity process has been produced by Accounting for Sustainability, The Church of England Pensions Board and Railpen.

With many DB schemes potentially heading towards insurance transactions, the charter sets out principles aiming to align expectations within this process and is expected to develop over time.

Four key principles are identified:

- **Transparency** – around values, principles and investment beliefs together with commitments around sustainability
- **Decision making** - how sustainability is built into decision-making and stewardship
- **Reporting and engagement** – beyond the transaction date
- **Collaboration** – a commitment to ongoing engagement as best practice evolves.

Signatories to date include a number of pension funds, insurers and advisers in additional to other industry participants.

Financial Markets Law Committee

The Financial Markets Law Committee issued a report on 6 February focussing on trustees taking action in line with their fiduciary duties. Clarification is given that trustees should take into account 'all relevant matters' in making decisions. This includes consideration of sustainability and climate change together with other issues. However, trustees need to consider the information needed from advisers and whether the trustees and advisers are aligned on such matters.

Trustees should consider what members should want to know before making any decision, though it is only the trustees who can apply judgement and make decisions within their fiduciary duty considering the purpose of the scheme and interests of members.

ESG Essentials (cont.)

TNFD

On 19 September 2023, the TNFD published its final recommendations for nature-related risk management and disclosures for companies and financial institutions, together with additional guidance to help companies and financial institutions get started with integrated assessment and corporate reporting.

The Recommendations build on those of the Task Force on Climate-related Financial Disclosures ("TCFD") and are consistent with the global sustainability standards of the International Sustainability Standards Board ("ISSB") and the impact materiality approach used by the Global Reporting Initiative ("GRI") and incorporated into the new European Sustainability Reporting Standards.

This was followed in December by the signing of a cooperation agreement between the European Financial Reporting Advisory Group ("EFRAG") and TNFD to enhance reporting on risks and impacts relating to nature.

Taskforce on Social Factors releases guide for industry consultation

The guide includes more than 30 recommendations for the UK pensions sector about how it can better consider and incorporate social factors into investment decisions and stewardship. The social factors under consideration range from workforce conditions and supply chains to community engagement, consumer protection and modern slavery.

The guide is split into three sections:

1. **Social factors and pension funds:** This section explores why material social factors are important from an investment perspective, and how taking these into consideration aligns with pension trustees' fiduciary duties.
2. **Social factor data:** This covers data trustees can use to manage social factors in investment, along with a materiality assessment framework to help prioritise areas for action.
3. **Addressing social factors in pension portfolios:** Guidance setting out a framework for addressing social factors in pension schemes, providing baseline, good and leading practice indicators, with a deep dive into the issue of modern slavery and how trustees can approach this social factor in their investments.

Appendices contain additional supporting materials, targeted at pension trustees, with a directory of data sources, guidance for effective stewardship and case study examples.

The Taskforce asked for feedback from the industry by Friday December 1st 2023.

TPR issues blog on climate scenario analysis

Following the publication of several reports criticising climate scenario analysis used by schemes, TPR climate and sustainability lead, Mark Hill, issued a blog saying that these reports rightly question the validity of some published outcomes, which appear to seriously underestimate the financial risk from climate change and are at odds with the established earth and climate science.

The blog goes on to recognise that although scenario analysis has its limitations, it can provide some insight, and that although trustees do not need to be climate experts, they should:

- have an appropriate level of knowledge and understanding of climate issues;
- undertake regular training and ask for additional training if they do not feel comfortable making decisions based on the information provided;
- regularly review the climate-related capabilities of service providers and consider the need for additional advisers or specialist input;
- be able to understand the narratives underlying their climate scenarios, the limitations of those scenarios and the assumptions made in their construction;
- broadly rationalise the outputs from those scenarios for their scheme; and
- consider with advisers the use of stress testing and tail risk analysis to complement their climate scenario input to investment strategy decision making.

Where trustees have already completed their scenario analysis but not finalised their TCFD report, it would be useful for members if trustees provided additional commentary in their report on the analysis they carried out and how they expect it to develop.

ESG Essentials (cont.)

FRC Thematic review of climate-related metrics and targets

The FRC has issued its thematic review report on climate-related metrics and targets which analysed disclosures of 20 companies across various sectors.

The review found an incremental improvement in the quality of net zero and interim emissions target disclosures. However, several areas were identified for further improvement, including:

- Reporting of company-specific metrics and targets, beyond headline 'net zero' statements;
- Linkage between metrics and targets and other areas of the annual report such as risks and opportunities and ESG targets in the Directors' Remuneration Report;
- Explanation of year-on-year performance against targets, and actions taken to reach targets;
- Identification of material metrics and targets used to manage risks and opportunities; and
- Avoiding boilerplate language.

The review identifies good-practice examples which provided information such as the expected steps to meet targets, areas of judgement and uncertainties, and details of the methodology applied in calculating non-standard metrics.

The FRC Lab has also issued its ESG data distribution and consumption report examining how investors use ESG data and sets out some clear principles for companies on reporting ESG data to facilitate consumption by investors.

Climate Change Governance and Reporting: Understand and increase confidence in disclosures

Assurance plays an important role in building trust around the robustness of non-financial information.

What about assurance?

Assurance is all about demonstrating the quality of data. One of the TCFD's principles for effective disclosure is that "disclosures should be reliable, verifiable, and objective". Assurance can provide an independent review of this effectiveness, and although assurance is currently voluntary, we are nevertheless seeing businesses gain assurance over certain climate-related financial disclosures, and we expect market leaders to move towards comprehensive assurance over disclosures to provide maximum comfort to their investors.

Mandatory assurance appears to be the inevitable next step in the reporting process. Indications are clear that corporate reporting will face some sort of mandatory assurance over the next twelve to twenty four months, and as a natural progression, pension schemes will undoubtedly follow. Not only does the assurance performed provide peace of mind for trustees in the early stages when data can be inconsistent, incomplete and unreliable, it can also help protect the reputation of pension schemes.

What are the benefits of assurance for trustees?

Enhanced creditability: A signal to stakeholders not only that the chosen metrics have been reviewed by an independent party, but also that the metrics are genuinely important to the trustees.

Drive improvement: In addition to an assurance opinion, improvement observations can be provided on the scheme's ESG processes and controls. This will focus on the quality of data which is frequently an area where management oversight and rigor is not as strong as for financial reporting.

Benchmark to best practice: Insight into disclosure seen elsewhere in the market and enhance the overall quality of non-financial reporting.

Regulatory readiness: Understanding and proactively managing the risks is key to developing a scheme that is 'regulation ready' and resilient to changing legislative demands.

Audit efficiency: There are a number of synergies to benefit from when those providing ESG assurance also provide the statutory audit.

Formal opinions over reported ESG metrics and disclosures can either be private or made public. These opinions are delivered in accordance with International Standard on Assurance Engagements ("ISAE") (UK) 3000 to either a limited or reasonable level of assurance (depending on stakeholder needs). Importantly, this will come with a private management feedback report with observations from the work. This service can be provided to audited entities and non-audit clients.

If you are interested in finding out more about our ESG Assurance services, please either follow this link, or get in touch with your usual engagement lead.

Call for Evidence conclusions and Superfunds update

Our Autumn update made note of the Government's Call for Evidence in respect of identifying whether there was scope to enable greater flexibility in how DB scheme assets are invested with the potential to work harder for members, employers and the economy.

In its assessment of the 92 responses provided by a variety of stakeholders, the government has stated it will:

- Make changes to the DB funding code of practice to support a less risk averse approach to encourage scheme investment in productive finance.
- Consult this Winter to determine whether the PPF could provide a public consolidator to reduce scheme costs and allow access to high-growth assets for smaller and less well funded schemes who are initially struggling to invest as they are seen as less attractive by commercial providers. The proposal aims to establish such a public sector consolidator by 2026. The consultation will also seek to explore the detail of these measures, including design, eligibility, safeguards, and the viability of a 100% PPF underpin.
- Work with stakeholders to ensure extracting surplus built up can be made easier if such schemes are investing in productive finance, whilst also protecting member benefits

The surplus repayment charge will also be reducing from 35% to 25% from 6 April 2024, with the consensus being that many sponsoring employers of well-funded DB schemes are expected to encourage trustees to consider options available to them to realise such surplus, taking advantage of this reduction and potential refund of surplus, notwithstanding the duty to secure member benefits.

Subsequently the Government has used these responses to open a further consultation on 23 February 2024 in order to gather additional evidence and background to inform the implementation process of the above suggested actions.

For those interested in further reading the Government response is available here:Options for Defined Benefit schemes - GOV.UK (www.gov.uk)

In other recent news, on January 10 in front of the Work and Pensions Committee ("WPC"), Economic Secretary to Treasury Bim Afolami confirmed that work is in progress on the anticipated permanent legislative framework for Superfunds, a permanent superfund regime.

However when questioned by Sir Stephen Timms, WPC Chair, around the timing of such legislation and whether this was ready to proceed to parliament, Bim Afolami was unable to confirm.

Whilst progressing, updates anticipated to the interim regime will not change in the near future despite the ongoing encouragement by the Government for consolidation to provide members improved options by benefiting from economies of scale in their pension investments.

Ending the proliferation of small pots: the multiple default consolidator model

On 22 November, the DWP issued a two-part document. The first part of this contained a response to their consultation which ran from 11 July to 5 Sept 2023 seeking views on proposals for a multiple default consolidator to 'sweep up' the current proliferation of small deferred pots.

The consultation, which received 55 responses, proposed automatically consolidating deferred small pots into one of a number of schemes authorised for this purpose. The second part of the DWP publication constitutes a call for evidence on the longer-term direction of occupational schemes – the so called lifetime provider or 'pot for life' model.

The DWP have concluded that the multiple default consolidator approach is the most appropriate and this will be legislated for when Parliamentary time allows. An industry delivery group has now been formed to delve further into complexities and issues to be addressed and allow further time for policy development.

A number of key issues are addressed in the DWP's response, these are explored below.

The need for a central clearing house

A mechanism is needed to let schemes know how to allocate member pots. The clearing house approach is preferred as it will offer an independent central point of contact for schemes and members, where members do not make any active choice. It is hoped that this will result in a low-cost system of benefit to members. The operation of the clearing house will be a priority concern for the industry delivery group.

Some members may express a consolidator of choice however it is likely that many will not. It is preferable that members are allocated into an existing pot with an authorised consolidator. For those who do not have such an existing pot, a carousel approach will be adopted allocating pots equally between authorised entities.

Authorisation to act as a consolidator

DWP aim for both trust-based and contract-based consolidators to be authorised and supervised. The response highlights certain authorisation criteria which include, inter alia:

- already undertaking same scheme consolidation,
- demonstration of good Value for Money,
- offering decumulation services including a default, and
- be of sufficient size to deliver value.

Eligible pot criteria

To be eligible for automatic consolidation, pots must be:

- created since the start of automatic enrolment,
- within charge-capped default funds within the automatic enrolment workplace market,
- have received no contributions for 12 months, and
- be valued at £1,000 or less (this criterion will be kept under review to ensure it remains valid).

Note that members will be able to opt-out of consolidation for example if they intend to return to the scheme in future.

The response also highlights key areas for the industry delivery group to consider. The group, launched in early 2024, will aim to give an update to Ministers in Spring / Summer 2024 and proposals in late 2024.

The second part of the DWP publication is a call for evidence looking at workplace pensions in the longer term, in particular whether a lifetime provider model would be beneficial in preventing further proliferation of small pots, how the CDC market can be grown and whether the two issues are linked. The closing date for responses was 24 January 2024.

Ending the proliferation of small pots: the multiple default consolidator model (cont.)

Changing work patterns mean that the traditional paternalistic model of occupational pension provision may no longer be appropriate. The creation of multiple pots brings difficulties for members in keeping track of their savings and increases the risk of small pots being 'cashed out', though the importance of dashboards in helping people see all their entitlements is noted. Small pots may also inhibit investment in productive finance, another of the Government's key initiatives.

DWP note that the lifetime provider model would reduce the number of pots and improve member engagement, schemes would have better data and access charges would be less. There may also be more opportunity to invest in illiquid assets which may result in higher returns for members.

The DWP are keen to understand how a central system to identify a lifetime provider can be operated such that choice for members can remain for those who are engaged but a default is embedded to capture those who do not make a choice. An interim step is proposed focussing on a voluntary, member-led model for those making choices. To facilitate this, changes would need to be implemented for example, to require employers to accede to payment of contributions to employees' scheme of choice.

The proposals will use policy developments in other areas to smooth the transition to a lifetime provider model with key elements being data standardisation, Value for Money, the multiple default consolidator model (including a central clearing house) and ensuring appropriate decumulation options (see article).

However, the DWP recognise that there could be challenges with a lifetime provider model. These include the impact on employers: specifically, would payment of contributions to varying different schemes affect the support provided to employees. Exemptions would also be needed where the scheme offered by the employer is better than the lifetime provider; adoption of minimum criteria for example in relation to fees and returns may be useful in understanding comparisons. There is also a desire to evolve the CDC market. Impacts are foreseen on payroll providers with a system like the banking 'BACS' system needed. The call for evidence discusses the need for the lifetime provider model to operate in conjunction with a policy consolidating existing pots and requests feedback on a 'whole system' approach vs adoption of a lifetime provider model solely for future accrual.

Other considerations are also noted including, for employers, whether schemes would need to be offered at all, for the industry, impacts on differing business models and, for individuals, the flexibilities needed.

The Government are keen to promote improved security, returns and reduce risk for members. Decumulation risks including 'cashing out' and a lack of member understanding are discussed with reference made to proposals of a duty on trustees to offer suitable decumulation services (see article).

CDC is noted as a possible solution. Such schemes spread risk between the membership during the accumulation and decumulation phase, thus reducing the risk of investment shocks and reducing the need for lifestyling. Pooling enables investment in higher growth assets for longer leading to the possibility of higher returns. Views are sought on whether use of CDCs for accumulation in auto enrolment would bring benefits although this would be a significant change to the status quo and the impact on the market for Pensions Freedoms products would need to be considered. A range of issues are noted for further consideration, including member access, employer understanding, market impacts and transition.

Possible benefits of adoption of CDC and the lifetime provider model together are discussed delivering savings in one place, a target income for life and enhancing outcomes with the potential for investment in productive finance through the decumulation phase. The default consolidator model could be used as a 'stepping stone' towards the use of CDCs and a lifetime provider. DWP are keen to understand the use of a CDC lifetime provider longer-term.

Decumulation: Helping savers understand their pension choices at the point of access

On November 22 the DWP published a response to their consultation earlier in the year looking at supporting scheme members at the point of accessing their benefits.

Key proposals, recognising the role of trustees in supporting membership, include a requirement for all schemes to offer a decumulation option. The consultation ran between 11 July and 5 September 2023, receiving 70 responses.

The response concludes that the most appropriate measures are:

- To legislate to introduce of a new duty on all trustees (to include the Nest scheme) to offer appropriate decumulation options at the right price. Whilst recognising that members with multiple pots may cause complexities, DWP believe these can be mitigated, notably through consolidation. Where schemes are not able to offer decumulation, then consolidation should be considered.
- To require provision of a default option. This may be done in partnership with other organisations. A good range of services will be ensured as partnership arrangements will not be restricted. Members making no active choice will be defaulted into a solution which they will then need to ‘opt out’ of if desired. The DWP will be flexible around default design though member communications will be key. In connection with communications, work is being undertaken by DWP together with the FCA and His Majesty’s Treasury (“HMT”) around the advice/guidance boundary.
- Before any legislative requirement, decumulation options will be encouraged and supported by guidance from TPR. In an industry speech, TPR noted 5 principles to ‘shape the conversation’ on decumulation including value for money, helping savers with decision-making, putting the saver at the heart of decumulation, market innovation and support offered by schemes. This was followed by a blog highlighting 7 challenges to be addressed by schemes in ensuring good decumulation outcomes and becoming ‘full-service providers’. If schemes are not able to do this, then consolidation should be considered.

DWP will monitor measures put in place together with the potential role for CDCs in decumulation to ensure that they are advantageous to members and a more prescriptive approach may be taken if required. CDCs may result in preferrable member outcomes and DWP consider them a possible model for the provision of future pensions. The CDC market is developing with the introduction of multi-employer schemes.

News in brief

The Purple Book 2023

In December, the PPF, issued the 18th edition of the Purple Book capturing the position of their DB universe at 31 March 2023. The analysis showed a net surplus on a s179 (PPF levy) basis of £358.9bn, representing more than 80% of schemes in surplus. The funding ratio has increased over the year to 134% (up from 113.1% in prior year). Statistics also identify that the PPF DB universe is highly fragmented and includes many smaller schemes.

Trustee jail sentence for illegal loans

In a case brought by TPR, a former trustee received a suspended 10 month jail sentence for extending 5 loans totalling approximately £700,000 to employer related entities. He must also undertake 150 hours of community work and pay £1,000 in costs.

TPR commented: “Rules restricting trustees from lending scheme money to a sponsoring employer are there to safeguard workers’ pension pots.

……………… as this prosecution shows, we will take tough action to punish those who risk the pension funds they are entrusted to look after.”

Scam case

A TPR investigation has led to two scam fraudsters being ordered to pay a total of almost £34,000 by Southwark Crown Court. The money has been handed to the impacted schemes. This follows the pair being jailed for this activity for a total of over 10 years in April 2022.

FRC updates to UK Stewardship Code signatory list

On 21 February, the FRC updated the list of signatories to the UK Stewardship Code. With 81 organisations renewing and one new addition, the total number of signatories now stands at 273 with assets under management of £43.3 trillion. The FRC note a ‘general improvement of stewardship practice’, with reporting on themes such as human rights, nature-based solutions and biodiversity, and climate change.

Collated guidance regarding stewardship reporting has also been published.

In late February, the FRC announced a review of the UK Stewardship Code to understand whether it 'supports growth and the UK’s competitiveness'. Views are being sought on whether the Code currently delivers better stewardship outcomes.

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