STEPHENSON HARWOOD
pensions law group

# Snapshot

February 2024

## Overview

- **Defined benefit funding regulations**

  The government has published the revised Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2024 (**Revised Regulations**). This draft addresses a number of concerns that the industry had over the initial draft of the regulations published in 2022 (**Initial Regulations**). The Revised Regulations now make provision for open schemes as well as having a clear emphasis that investment decisions remain with the trustees and the trustees alone. Amendments have also been made to ensure that schemes should not be required to unnecessarily de-risk.

- **The General Code and its Explanatory Memorandum**

  The Pensions Regulator (**Regulator**) has published its long awaited final General Code (**Code**). There are some changes in this final draft from the initial, including over the timing of the Own Risk Assessment (**ORA**) and the details required in the remuneration policy. The Code is expected to come into force on 27 March 2024.

- **Labour's Pension Plans**

  The Labour Party has recently published a policy paper which includes some detail on its vision for pension scheme reform. This largely centres around (i) increasing pension schemes' investments in the UK economy; and (ii) increasing the Regulator's powers in the area of consolidation of underperforming defined contribution (**DC**) schemes.

- **New Pensions Regulator guidance on private markets investment**

  The Regulator has issued new guidance for trustees of occupational pension schemes who are considering investing in private markets. The main asset classes in this market are private equity, private debt, private real estate and infrastructure and natural resources.

- **Court upholds amendment only to the extent it does not breach the amendment power**

  In the recent decision of *Avon Cosmetics Ltd v Dalriada Trustees Ltd,* the court ruled on the validity of an amendment which would bring about closure of a defined benefit section to future accrual. This amendment would impact some (but not all) members in such a way that, for those members only, the change was in breach of a proviso in the amendment power. The court upheld the amendment, but only to the extent it did not breach the amendment power.

- **Court rules on restrictive amendment power and age discrimination issues**

  In the case of *Newell Trustees Ltd v Newell Rubbermaid UK Services Ltd*, the court ruled on whether the transfer of members from a defined benefit (**DB**) section of a scheme to a defined contribution (**DC**) section based on age: (i) breached the scheme's restrictive amendment power; and (ii) amounted to age discrimination.

## Defined benefit funding regulations

The Pension Schemes Act 2021 provided for a framework for a new defined benefit funding regime. The detail of what this would mean in practice was to be set out in regulations. Back in July 2022, the DWP consulted on the Initial Regulations which set out much of the detail of the new funding regime. Our briefing at that time set out further detail on this first draft.

The government has now published its response to the consultation replies, together with the Revised Regulations.

The Regulations will come into force on 6 April 2024 and will apply to valuations with effective dates on and after 22 September 2024.

Trustees of defined benefit occupational schemes will be required to have a funding and investment strategy. A key principle that must be followed when determining or revising the funding and investment strategy is that schemes must be in, at least, a state of **low dependency** on their sponsoring employer by the time they reach the Relevant Date. The Relevant Date is a date not later than the end of the scheme year in which the actuary estimates the scheme is expected to reach **significant maturity**. Further employer contributions should not be expected to be required to meet the scheme's liabilities after this time.

### The Relevant Date

There was concern that the requirements in the Initial Regulations could impact the trustees' independence when choosing scheme investments. The Revised Regulations now provide that the funding and investment strategy does not create a regulatory requirement to invest in the way set out in the strategy on and after the Relevant Date. However, it is a regulatory requirement that on and after the Relevant Date the scheme must be fully funded on a low dependency funding basis.

### Significant maturity

The Initial Regulations provided that scheme maturity would be measured in years using a duration of liabilities measure. Many in the industry were concerned that this measure would cause uncertainty since it is sensitive to market conditions. As a result, the Revised Regulations now provide that when determining this, the economic assumptions used will be based on the economic conditions on 31 March 2023.

The Regulator's forthcoming code of practice will specify the period at which a scheme will reach significant maturity.

The Revised Regulations also now make provisions for open schemes to make reasonable allowances for new entrants and future accrual in some scheme maturity calculations. This approach will allow some open schemes to fund on the basis that it will not begin to mature soon.

### Low dependency investment allocation

Whilst mature schemes will need to have a low dependency on the sponsoring employer, there was concern in the Initial Regulations that the way this was formulated would mean that the ability for trustees to invest in higher growth assets would be excessively restricted for these schemes. As a result, amendments have been made in the Revised Regulations to remove the original requirements that assets had to be invested in a way that the cashflow from the investments broadly matched the payment of benefits. The intention is to allow schemes to invest a reasonable amount in a wide range of assets after significant maturity.

### Recovery plan

The Revised Regulations now require the impact of the recovery plan on an employer's sustainable growth to be taken into account when preparing or revising a recovery plan. The requirements in the Initial Regulations for trustees to follow the principle that the deficit should be recovered as soon as the sponsoring employer can reasonably afford when preparing a recovery plan, has been retained.

## Comment

It seems the government has taken on board a number of the industry's concerns in drafting the Revised Regulations. There is a clear emphasis that investment decisions remain with the trustees and the trustees alone, and that schemes should not be required to unnecessarily de-risk. The full picture of the new regime cannot, however, be fully understood without sight of the Regulator's final code of practice on this new funding regime. It is hoped the industry will not have to wait too much longer before this is published.

Further information can be found in our briefing on this topic.

### The General Code and its Explanatory Memorandum

The Code, which was laid before Parliament on 10 January 2024, consolidates ten of the sixteen existing codes of practice on the governance and administration of pension schemes published by the Regulator. The Code covers aspects of governance common to all types of schemes and sets out the standards of conduct and practice applicable to trustees and scheme managers. The Code does not make changes to the law but rather either re-states the Regulator's previous guidance or updates that guidance in line with changes in legislation since the ten codes were written. Although the Code is not legally binding, it can be used in legal proceedings as evidence in support of a claim of non-compliance with a legal requirement. The Regulator may also cite its expectations, as set out in the Code, when taking enforcement action.

The Code has been amended somewhat since its previous publication in draft form in 2021. The Code is now presented in a web-based modular approach, with the material written into 51-topic based modules in a manner that is clearer and easier to understand. In terms of its content, trustees and scheme managers should note:

- The annual Own Risk Assessment (**ORA**) requirement has been amended so that schemes will instead be able to carry out an ORA on their own timetable, in part or in whole, provided that it is carried out in its entirety at least every three years.
- The requirement to maintain an effective system of governance for selecting and appointing advisers and service providers by running a tender process every two years has been amended to allow for this to be done every three years.
- The requirement for schemes to prepare a remuneration policy explaining their decision-making and rationale has been clarified. Now, the requirements as to the scope of the policy will be much more scheme-specific and the policy does not need to contain disclosure specific remuneration figures (but rather set out a general assessment on value for money).
- The Regulator's 2018 guidance on cyber risk has been incorporated into the Code, which emphasises the importance of reducing the risk of a cyber-attack and of including risk reduction measures in the effective system of governance.
- Reference is now made to adhering to the principles set out in Regulator's Equality, Diversity and Inclusivity guidance published in March 2023.

The Code is expected to come into force on 27 March 2024 and, in the meantime, the Regulator has challenged governing bodies to use this time as an opportunity to ensure schemes are compliant. The Regulator has encouraged governing bodies to "*use their judgment as to what is a reasonable and suitable method of ensuring compliance for their scheme*". When considering the compliance of their scheme with the Code, trustees and scheme managers should:

1. Check that their effective system of governance addresses the expectations set out in the Code.
2. Prepare and document the first ORA within 12 months after the end of the first scheme year (after 27 March 2024).
3. Establish an appropriate risk management policy.
4. Ensure that the necessary member communications have been made.
5. Consider undertaking training on the Code to ensure that trustees have a working knowledge of its expectations and an awareness of those areas not within its scope, such as notifiable events and funding defined benefits.

The new Code places a lot of emphasis on compliance with the Code needing to be proportionate to the type and size of scheme. We understand that the Regulator appreciates some schemes may have been waiting for the final Code before finalising their compliance and therefore schemes may not be fully compliant by 27 March 2024. However, as much of the content of the Code is not new but a reflection of previous codes of practice, the Regulator does expect schemes to already be compliant with those aspects. We also understand that the Regulator expects schemes close to buyout to have a significant degree of compliance with the Code, given key decisions relating to the scheme occur in buyout phase.

Further information can be found in our briefing on this topic.

## Labour's Pension Plans

On 30 January 2024, the Labour Party published its policy paper "*Financing Growth – Labour's Plan for Financial Services*", which the Party describes as "*the first stage in outlining Labour's vision*."

This relatively brief, 28 page (including end-notes), paper covers a lot of ground, from measures aimed at maintaining and improving the City of London's pre-eminence, to the creation of local banking hubs. It does, however, also manage to squeeze in a few paragraphs setting out, at least some of, the Party's pension plans.

Beyond some brief references to providing better advice to pension savers and some plans in respect of the Local Government Pension Schemes, the Party's pension plans largely revolve around getting pension schemes to invest more in the real economy.

The paper states that one of the Party's priorities is to "*reinvigorate our capital markets by reviewing the pensions and retirement savings landscape, enabling greater consolidation of all types of schemes.*"

The note then goes on to identify the UK's problem with "*de-equitisation*", i.e. a fall in share ownership in UK companies, and that the reduction in pension scheme equity investments is a big part of this trend. The paper says that pension scheme and insurers have gone from holding 39% of UK equities in 2000, to just 4% in 2020. This, they say, is the result of a number of causes, "*including accounting standards, regulation, tax treatment, and an emphasis on cost rather than* *value. The closure of defined benefit schemes to new members has shifted their risk profile to focus on guaranteed long-term cashflow rather than growth investment."* This has, in turn, led to investment in UK companies drying up and depriving pension savers of higher long-term returns on growth assets.

To address this issue, the Labour Party has committed to undertaking an "*in-government pension and retirement saving review*", which will consider all types of pension arrangements, as well as sponsoring employers, asset managers and VC's and private equity. In doing so, the review will seek to determine whether "*the current framework will deliver sustainable retirement income for individuals*." It will also "*identify and tackle the barriers to pension schemes investing more into UK productive assets – including cultural and regulation – induced risk aversion*."

Beyond this, the Party has committed to taking steps to "*enable greater consolidation across all pension and retirement savings schemes."* This is, of course, very similar to the current government's own commitments in this area. However, Labour has, so far, gone further in at least one way. It has committed to "*give [the Regulator] new powers to bring about consolidation where [DC] schemes fail to offer sufficient value for their members, and will ask [the Regulator] to provide explicit guidance around fund and strategy sustainability, and their expectations of a default cohort investment approach",* as well as keeping *"the minimum thresholds for scheme performance under review to ensure continued improvement in returns where possible*." In essence, the Regulator will be able to force the consolidation of underperforming DC schemes.

Beyond this, Labour has recommitted to creating a British version of the French "Tibi" scheme, to allow DC schemes to invest a small amount into VC, small cap growth equity and infrastructure investments.

The detail of Labour's policy is fairly skeletal this far out from an election but, as it stands, it is largely a continuation of the current government's policy, with a small number of, possibly, fairly radical additions.

## New Regulator guidance on private markets investment

New guidance for trustees of occupational pension schemes who are considering investing in private markets has recently been issued by the Regulator. The main asset classes in this market are private equity, private debt, private real estate and infrastructure and natural resources.

The guidance follows on from the Government's Mansion House reforms announced last year, which we discussed in our September snapshot, which were designed to enable the financial services sector to unlock capital for UK industries and increase returns for pension savers while supporting growth across the wider economy. It seeks to highlight the opportunities private markets investments provide, making clear that, with the right advice and effective governance, private market assets can play a valuable part in a diversified scheme portfolio that aims to improve and protect saver benefits.

Areas covered by the guidance include:

- a general overview of private markets asset classes;
- opportunities and risks associated with investing in private markets;
- legal duties of trustees when investing, including having a diversified portfolio that is predominantly in assets that are traded on a regulated market; and
- key considerations when looking to invest in private markets - such as knowledge and understanding, taking appropriate investment advice, investment requirements and scheme

governance - and the different considerations for defined benefit and defined contribution pension schemes.

The Regulator recognises that different schemes with the same status (e.g. closed, closed with accrual or open) will have different levels of funding, employer support, return targets and objectives and that those factors will influence capacity and willingness to invest in some private market investments. A helpful table is therefore included which illustrates potential scheme appetite for different types of private market investments depending on those factors.

The Regulator points out that the guidance is not designed to tell trustees how to invest scheme assets, but rather to encourage trustees to focus on delivering value from investments and to have the right skills and expertise to consider all asset classes. Its view appears to be that while private market investments generally carry higher costs, they can have a positive net impact on the value delivered.

## Court upholds amendment only to the extent it does not breach the amendment power

### Facts

The case of *Avon Cosmetics Ltd v Dalriada Trustees Ltd* explores the validity of one of a number of amendments made to the Avon Cosmetics Pension Plan (the "**Scheme**"). The power of amendment in the scheme was subject to the fetter that members cannot be prejudiced by the amendment (the "**Fetter**").

The proposed amendments closed the defined benefit section of the Scheme from the closure date and members' benefits would be based on their period of service and salary as at the closure date. The members' benefit would then be subject to revaluation from closure to retirement.

The amendments had the effect of improving the financial position of a certain group of members while disadvantaging another group. This occurs because during the period between the closure date and the date of retirement of a member, certain members would have seen their salary increase at a rate greater than the revaluation rate (the "**FS Winners**") whereas other members would experience the opposite (the "**Revaluation Winners**"). This was therefore in breach of the Fetter in respect of the FS Winners.

Part 8 proceedings were brought on the issue of whether the infringement of the Fetter resulted in the amendments being either (i) wholly invalid or (ii) partially invalid in respect of only those who are prejudiced.

### Decision

The court determined that the key principle in challenging fiduciary power here was "excessive execution" where an exercise of power exceeds its jurisdiction and, in such scenario, "*the court will naturally incline to uphold the validity of the exercise so far as it can*". The first step toward partial validity required demonstrating a conceptual difference between valid and invalid exercises of power and the judge was satisfied that the prejudiced and non-prejudiced groups were "*sufficiently different and identifiable*" despite the assertion put forth by the Defendants that they could only be categorised separately at a future, unspecified date.

Furthermore, the court clarified that evidence of the trustees' consideration regarding potential invalidity was not necessary. Rather, an objective inquiry into their intentions should be conducted. Therefore, the Judge concluded that the objective intention of the amendment was to close the defined benefit section to future accrual. The Fetter prevented the amendment taking effect in respect of the FS Winners but the amendment in respect of the Revaluation Winners was "*within the overall objective intention*" of the Amendment. Accordingly, partial validity should be upheld as it "*effect[s] no change in the substantial purpose and effect of the impugned provision*". The amendment was therefore valid in respect of the Revaluation Winners only.

This case is one in a series which show the extent to which a scheme can close to future accrual or break a final salary link will depend upon the terms of the amendment power within the scheme."

## Court rules on restrictive amendment power and age discrimination issues

In the case of *Newell Trustees Ltd v Newell Rubbermaid UK Services Ltd*, the Parker Pension Plan (the "**Plan**") was governed by an interim deed dated 18 September 1979 (the "**1979 Deed"**). Until 1992, this was a DB plan (the "**DB Section**"). In 1992, an amending deed (the "**1992 Deed"**) was executed, purporting to introduce a DC section (the "**DC Section"**) into the Plan. Members of the Plan under 40 years old were transferred from the DB Section into the DC Section.

The 1979 Deed's amendment power contained a *Courage*-style proviso in the following terms: "*provided that no such alteration cancellation modification or addition shall be such as would prejudice or impair the benefits accrued in respect of membership up to that time.*" (the "**Proviso**")

### The Transfer and Conversion Issues

1. *The RepBen argued that the Proviso prevented the conversion of the members from the DB Section to the DC Section*

Justice Green (the **Judge**) concluded that the conversion was implemented validly, stating that the Proviso protected the value of members benefits, rather than the method of calculation. The Judge also stated that the wording of the Proviso, specifically the word "*would*", meant that it could not be shown the member would be worse off in financial terms due to the conversion.

2. *The RepBen argued that the Proviso prevents the members final salary link from being broken*.

Both parties agreed that an impact of the conversion meant that the final salary link had been broken. The Judge, in line with the decision in *Courage,* had to read in an underpin to maintain the final salary link so that the conversion was within the scope of amendment power.

### Age Discrimination Issue

The RepBen argued that the 1992 Deed breached age discrimination laws that were established in 2006, by moving all members under 40 into the DC Section, and as a result Trustees would be obliged to pay benefits which were less favourable to those younger members.

The Judge decided that there was no age discrimination either in the rules of the scheme itself or in the way that the trustee is bound to act at the point when benefits are paid to the members. The Judge also stated that the decision was taken in 1991/2 to split the members into groups on the grounds of their age and even if that amounted to a form of age discrimination, it was lawful to do so at the time it was done. The Trustee is now obliged to pay benefits in accordance with the relevant section's rules, irrespective of how the member became a member of that section and irrespective of their age.

## Contacts

### Philip Goodchild

Partner, Pensions
T: +44 20 7809 2166
E: philip.goodchild@shlegal.com

### Stephen Richards

Partner, Pensions
T: +44 20 7809 2350
E: stephen.richards@shlegal.com

### Chris Edwards-Earl

Partner, Contentious trusts
T: +44 20 7809 2113
E: chris.edwards-earl@shlegal.com

### Julia Ward

Senior knowledge lawyer, Pensions
T: +44 20 7809 2028
E: julia.ward@shlegal.com