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PENSIONS QUARTERLY UPDATE

CONTENTS

In this Quarterly Update we cover the following topics:

KEY DEVELOPMENTS

DB SURPLUS AND THE ARCADIA CASE

On 3 February 2025, the High Court approved an amendment to the trust deed for the Arcadia staff pension scheme (Staff Scheme) to accept a transfer-in from its sister scheme, the Executive Scheme. The trustee of the Staff Scheme had asked the court to confirm this amendment was within its powers and to approve its decision. Merging the underfunded Executive Scheme with the Staff Scheme allowed the Executive Scheme members to benefit from the surplus in the Staff Scheme meaning that members of both schemes can receive the benefits to which they are entitled in full.

By way of background, the schemes had historically been run as "sister schemes" with overlapping governance structures and the intention that both schemes should achieve similar funding levels. Following the collapse of the Arcadia group both the Staff Scheme and the Executive Scheme entered wind-up, and a Pension Protection Fund (PPF) assessment period.

To effect the merger, the Rules of the Staff Scheme had to be amended because they expressly prohibited a transfer-in. The Court considered that the amendment power was widely and flexibly drafted, including contemplating amendments after scheme wind up had been triggered, and that as a result there was no reason why an amendment could not be made during the course of wind-up.

The Court further held that an amendment resulting in the dilution of surplus in one scheme for the benefit of the beneficiaries of another scheme could be a proper exercise of the trustees' powers.

In some respects this decision is useful to employers and trustees with multiple group schemes; the Court gave some views on the wide range of interests and circumstances that may be relevant to the treatment of surplus. However, in practice we expect the decision to be largely limited to its facts. The Staff Scheme amendment power was unusually flexible, members had no entitlement under the Staff Scheme Rules to benefits in excess of the basic entitlement, and both schemes were in windup and a PPF assessment period.

PENSION PROTECTION FUND (PPF): A THREE-YEAR STRATEGIC PLAN

At the time of its twentieth anniversary the PPF has published a timeline of key achievements along with a strategic plan for the next three years (2025-2028)

The strategic plan sets out a number of strategic priorities along with four key outcomes:

+ Deliver strong investment performance to ensure financial security for those we protect
+ Maintain excellent service, securing high satisfaction levels for members and levy payers.
+ Partner with government and the pensions industry to help give people greater financial security in retirement, both for the members of the schemes we protect and more widely.

+ Inspire our people to achieve these ambitions so that they are engaged and proud of the role we play, and able to contribute to their full potential.

The PPF's stated goals include:

+ Collaborating with the government to update legislation, aiming to create a framework that allows for a zero levy while maintaining the ability to reintroduce it if necessary.
+ Integrating PPF and Financial Assistance Scheme data into the dashboards programme.
+ Working with government and other stakeholders to consider how the skills, capabilities and resources of the PPF could be leveraged for the benefit of pension savers and the pensions sector.
+ Reviewing the indexation of PPF compensation.
+ Improving the speed of the decision-making process for PPF+ cases (being those schemes that enter a PPF assessment period with assets in excess of expected PPF liabilities).

PASA PUBLISHES UPDATED GUIDANCE ON DATA READINESS FOR BUY INS AND BUY OUTS

PASA published updated guidance on data readiness for buy-ins and buy-outs on 9 April 2025.

The objective of 'data-readiness' is to ensure data is complete, accurate and held in a consistent electronic format to proceed with an insurer transaction. For de-risking projects with insurers, high quality data can enable smooth, efficient, and preferential pricing terms, whereas inadequate data often results in higher transaction costs, delay, and uncertainty.

Insurers expect trustees to undertake all essential data-cleansing activities to ensure beneficiaries have their correct benefit entitlements established, particularly in the period between a buy in and buy out. The data-cleansing process can run for many months although the duration is usually shorter for well-prepared schemes.

Accurate and complete data supports every aspect of the management and delivery of scheme benefits. PASA's newly updated guidance sets out a process for ensuring member data is accurate and comprehensive:

+ **Project Planning:** Collaborate with potential insurers to define project aims and data targets, decide on breaking down data cleansing into smaller workstreams, and appoint responsible stakeholders.
+ **Data Management**: Create a data schedule to map data items from administrative systems and additional sources. This involves documenting the production of output files for consistency and conducting a full assessment of benefits to be insured, guided by a benefit specification approved by legal advisers.
+ **Data Audit:** Engage professional advisers to identify and discuss incorrect, inconsistent, or incomplete data issues, such as manual backfile reviews, contingent spouse pensions, marital status updates, communication gaps with deferred members, and more.

- **First Principles Review:** Conduct a data and benefit audit based on first principles to validate assumptions, considering the results from recent Common and Scheme Specific data scores.
- **Resolution of Data Issues:** Address minor data issues on a case-by-case basis, preparing for insurers' data requests to cover all eventualities described in the benefit specification.
- **Dashboard Readiness:** Ensure schemes are ready to connect to the pensions dashboard if there is any risk that buy-out will not be fully complete before the 2026 dashboard final connection date. As we get closer to that date insurers are increasingly requiring dashboard readiness just in case buy-out does not complete in time.

The guidance helpfully includes a table of key data items that trustees should expect to be required to provide to an insurer during the buy-out process.

PROFESSIONAL TRUSTEES: OVERSIGHT BY THE PENSIONS REGULATOR

Nausicaa Delfas, Chief Executive of the Pensions Regulator (TPR), used her speech on 2 April at the Trades Union Congress pensions conference to set out how TPR plans to extend its oversight of professional trustees (PTs).

Currently, over half of UK pension schemes use professional or sole trustee models, and ten professional trustee firms are responsible for more than £1 trillion of savers' retirement income. Recognising a significant shift in the pensions landscape towards "mega schemes" and PTs, TPR has spent the past six months gathering information from eleven major trustee firms, identifying diverse business models and considering how to change its regulatory approach to ensure every pension saver is in a "well-run, well governed, value for money pension scheme".

TPR looked at five key areas: ownership structure, skills and experience, knowledge and understanding, diversity, equality and inclusion, conflicts of interests and fees. TPR's findings are set out in a market oversight report which highlights potential risks in employer relationships, profit models, sole trusteeship, in-house advisers, and scheme decision-making.

TPR intends to introduce a framework for oversight of PTs. TPR will start by establishing ongoing supervisory relationships with PT firms, starting this summer as TPR tests and refines its new framework for education and engagement. TPR expects that increased oversight will allow it to assess the risks it has identified in the PT market in greater detail and to work with PTs to implement appropriate mitigation for such risks. Ultimately, TPR intends that increased oversight will highlight good practice and raise standards across the market.

TPR REPORT ON CLIMATE CHANGE RISKS FOR UK SCHEMES

Following an initial report on climate change in October 2021, TPR published its second climate adaptation report on 10 April 2025. In the report, TPR explains how it is embedding environmental, social and governance (ESG) considerations, including the impacts of climate change, across its regulatory and corporate activity. Collaboration with government and industry is a key part of TPR's strategy to enhance the management of climate and ESG risks.

Occupational pension schemes face climate-related risks through their investment portfolios and defined benefit schemes rely on the ability of their sponsoring employers to withstand climate change impacts, ESG challenges, and broader sustainability issues including ecological and biodiversity concerns.

TPR's report divides those risks into three categories:

1. **Physical Risks:** These range from acute risks, for example storms and wildfires that cause immediate damage, to chronic risks such as ongoing droughts and flooding. All of which can lead to asset degradation and disruption in supply chains.

2. **Transition Risks:** These stem from structural economic changes towards a low-carbon economy, guided by global climate policy objectives. The risk level depends on the scheme's capacity to adapt quickly, appropriately and whether that response occurs smoothly or chaotically.

3. **Legal and Litigation Risks:** These arise when entities fail to consider the physical or transition risks associated with climate change. Pension schemes are vulnerable if their sponsor companies or invested companies do not effectively plan and adjust to climate challenges.

TPR encourages trustees to focus on long-term investment strategies that mitigate financial risks associated with climate change and nature loss, ensuring robust investment governance for the benefit of savers.

Recognising smaller schemes often have trustees with limited awareness of climate risks, TPR recommends consolidation where necessary to maintain competitive value and governance standards. This fits with the trend in occupational defined contribution pension schemes towards consolidation into fewer, larger, and better-managed entities.

SMALL POTS: GOVERNMENT PLANS FOR A CONSOLIDATOR

Automatic enrolment and increasingly frequent job changes have led to an increase in small, deferred DC pension pots. Currently, thirteen million pots are in-scope, and this is due to grow by one million pots each year. The total annual cost to the pensions industry to oversee these small pots is approximately £225 million, equating to £20 per pot. The Government believes consolidation could boost retirement savings for the average worker by £1000 and save businesses these high and unnecessary administration costs.

Proposals for dealing with small pots were put forward by the Department for Work and Pensions in November 2023 and provision for small pots in the 2025 Pensions Bill, was promised in the King's Speech last year. On 24 April, the Government provided further information about how consolidation would work.

The November 2023 proposals were:

- A pot would be in scope if it was in a default fund under an auto-enrolment scheme, had received no contributions for at least 12 months, and was under £1,000.
- A scheme would be required to transfer an in-scope pot to a default consolidator, but with members having the chance to opt out or choose a consolidator for themselves.A central hub would underpin and support the consolidator system.
- Consolidators would be subject to authorisation and supervision.

Key elements of the April 2025 proposals are:

1. Consolidation will be via a system of multiple default consolidators (MDCs).
2. Schemes have 12 months to complete the transfer process once a pot is identified for consolidation.
3. A central hub, the Small Pots Data Platform, will allocate members between consolidators, although members will be free to choose otherwise.
4. Members will be allocated to consolidators based on the "largest pot" principle or via a carousel system if they have no existing pots with a consolidator.
5. Funded via the General Levy, the Small Pots Data Platform will be responsible for identity verification, data matching, and facilitating the consolidation of small pension pots.
6. Trust-based consolidators must be authorised under a regime similar to that used for existing master trusts, such that they meet prescribed conditions, including in respect of scale, value-for-money, and member protections.
7. The Government will collaborate with the Financial Conduct Authority to establish a similar framework for contract-based providers.
8. A liability framework will ensure member reinstatement if errors occur, with the Pensions Ombudsman's role extended to facilitate that.

The government will carry out a feasibility review to determine the viability and practicality of the policy design recommendations in relation to the infrastructure that will be required to enable the consolidation of small pots. Findings will be reported back to DWP in June 2025.

The government recognises the challenges which large-scale consolidation will bring and has factored this into the timetable, meaning the main requirements are unlikely to come into force until 2030. It is expected that Regulations will be drafted in 2026, that some of the associated legal obligations will come into force in 2027 - 2028, and that the duty to transfer and consolidate eligible pots will likely come into force during 2030.

OTHER MATTERS OF INTEREST

MANSION HOUSE COMPACT II

We understand that later this summer the Chancellor will announce an updated version of the Mansion House Compact. Compact II will aim to encourage providers to invest 10% (rather than the current 5%) of defined contribution default assets into unlisted assets by 2030, with half of that investment focused on the UK.

DRAWDOWN: PTM062701 UPDATED TO CLARIFY THE INTERPRETATION OF AN EFFECTIVE DESIGNATION

On 26 March 2025, HMRC revised the Pensions Tax Manual (PTM) to clarify that taking a pension commencement lump sum (PCLS) or "tax-free cash" is only possible where the member could access income drawdown from the scheme, irrespective of whether the pension scheme makes a drawdown payment to the member.

The updated PTM provides helpful guidance on what it means to effectively designate funds to drawdown. Specifically, and as one might imagine, HMRC has clarified that an effective designation can only be made if the member could in reality receive income drawdown from the scheme in question.

Designating funds for drawdown does not oblige a member to take an immediate drawdown payment, even where a pension commencement lump sum is paid in connection with the designation. Although the guidance confirms that it is for trustees to have their own process in place for how a member can designate funds to drawdown, it is important that designation to drawdown is effective and we therefore recommend that trustees, pension scheme members, and their advisers have regard to this updated guidance when considering drawdown designations.

TPR BLOG ON SMOOTH TRANSFERS TO A PENSION SUPERFUND

On 23 April, TPR published a blog post from David Walmsley, TPR director of Trusteeship, Administration and DB Supervision. Sharing top tips gleaned from the first three transfers to the Clara superfund (Sears, Debenhams, and Wates), the blog focusses on TPR's experience of the friction points that occurred during those transfers and offers advice on how to minimise those in future transactions:

1. Uncertainty and misconceptions about the expectations from trustees and employers regarding transfers to a superfund was a recurring issue. To address this, TPR recommends familiarity with both its guidance for DB superfunds and related advice for trustees and employers.

2. Gateway Test 1 – Buyout Cost: Trustees do not need an official buyout quote from insurers; an objective estimate from a market-experienced actuary will be good enough.

3. Diligence on Superfunds: TPR has vetted the legal and governance structures of superfunds listed on its website, so minimal additional diligence is acceptable.

4. Rationale for Transferring: Trustees must thoroughly understand the superfund's business model and the transaction details. This includes cash injections, capitalisation, employer involvement, and how any surplus would be distributed.

5. Having on-going employer support is not a complete block to a transfer.

6. TPR expects there to be a comprehensive rationale, backed by advice and evidence, setting out why the transfer is in the members' interests. This is vital where the scheme has on-going employer support.

7. Gateway Test 3 – Transfer Improves Likelihood of Full Benefits: This assessment is judgment-based, and a key factor is the employer's capacity to support the scheme outside the superfund. Mathematical quantification is not necessary, but stochastic asset-liability modelling can be useful.

8. Bulk Transfer Terms: Transfer terms, including financial contributions, are often based on the scheme's financial status months prior. Clauses in transfer agreements should allow reassessment if market conditions change, though maintaining these right up to transfer is impractical. TPR accepts boundary conditions ending on member notification day but will require an explanation as to why the parties are comfortable with this arrangement.

9. TPR encourages schemes contemplating a transfer to a superfund to engage with the organisation via email to SuperfundTransfers@tpr.gov.uk.

10. Providers who may be considering entering the superfund market should contact TPR to have an early conversation about that step by emailing authorisationteammailbox@tpr.gov.uk.

11. Finally, TPR promises "forthcoming 'Defined Benefit Scheme Endgame Options Guidance' which will explore the wider range of options available in 2025 for DB schemes."

THE PENSION SCHEMES BILL 2025

Based on media statements from the Pensions Minister, Torsten Bell, we now know that the Pension Schemes Bill is due before Parliament's summer recess and it will contain a small pots solution.

We hope it will also include a provision, promised in the Kings Speech in July 2024, reaffirming that the Pensions Ombudsman (TPO) is a competent court, resolving issues created by a Court of Appeal decision in November 2023.

PENSIONS DASHBOARDS

On 28 April 2025, Origo announced that it had successfully completed integration and operational acceptance testing and is now fully linked to the government's pensions dashboards ecosystem ahead of the guidance date of 30 April 2025. Origo is the first provider to connect to the platform.

TPR has also published four short films highlighting the difference pensions dashboards will make to savers, along with five actions for scheme trustees to take now to prepare for their dashboards connection date:

1. Start preparing data now – make sure it is accurate, accessible, and digital.
2. Download TPR's checklist to keep on track of dashboards preparations.
3. Nominate a pensions dashboards contact through TPR's Exchange portal to receive communications and guidance to help prepare.
4. Work collaboratively with your administrator, AVC providers, and others supporting your scheme throughout the process.
5. Keep a record of decisions and preparations and maintain oversight at board meetings.

See our Dashboards Checklist here.

AN UPDATE ON SECTION 37

On 25 March 2025, the Pensions Minister, Torsten Bell, confirmed the government is "actively considering" the issues raised by the *Virgin Media* case and so-called "section 37 issues".

In addition, we hope that clarity on aspects of the *Virgin Media* decision will come later this year, following the six-week Verity Trustees (The Pensions Trust) hearing in the High Court which started on 12 February and ended on 28 March 2025 (*Verity Trustees Limited v Wood*).

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