SLAUGHTER AND MAY/

PENSIONS ESSENTIALS

July 2024

QUICK LINKS

Court of Appeal decision in Virgin Media

DB Funding Code

Pension Schemes Bill

Pensions review

Court of Appeal on meaning of "interests" in amendment power

Auto-enrolment decisions

Watch list

One Bunhill Row
London EC1Y 8YY
United Kingdom
T: +44 (0)20 7600 1200

COURT OF APPEAL DECISION IN VIRGIN MEDIA

The Court of Appeal has confirmed that prior to 6 April 2016, actuarial confirmation was required to amend contracted-out reference scheme test benefits and that the absence of such confirmation can render an amendment void. The requirements changed over time, but prior to 6 April 2013, confirmation was required in relation to both past and future service amendments, and also for amendments that improved member benefits.

Section 37 Pension Schemes Act 1993 provides that the rules of a scheme that was contracted-out on a final salary basis cannot be amended unless conditions set out in regulations are complied with, and if these conditions are not complied with the amendment will be void. The conditions have changed over time.

In relation to amendments affecting reference scheme test benefits, between 6 April 1997 and 5 April 2013 amendments could not be made in relation to any "*rights to the payment of pensions and accrued rights to pensions*" unless the trustees had first informed the actuary in writing and the actuary had confirmed in writing that the scheme would continue to satisfy the reference scheme test. From 6 April 2013 to 6 April 2016 the requirements were changed to require written actuarial confirmation that the reference scheme test would continue to be met for future service benefits. From 6 April 2016, actuarial confirmation was no longer required.

The Virgin Media case concerned an amendment to a contracted-out scheme which was made in 1999 and which sought to reduce the rate of deferred member revaluation. It was assumed that no section 37 confirmation could be found so the question arose as to whether the amendment was void and if so, to what extent. The High Court concluded that an amendment was void if the actuarial confirmation required was not obtained. For the purposes of the conditions as they stood in 1999 (and until 2013), that meant that amendments which affected both past and future service reference scheme rights were void, even where such amendments would have been beneficial to members.

The employer appealed and asked the Court of Appeal to consider whether the conditions for amendment which applied up to 2013 related to both past and future service amendments or to past service only. No appeal was made on the question of whether the absence of actuarial confirmation was sufficient to render an amendment void, or whether benefit improvements were also caught by the requirement for confirmation.

The Court of Appeal unanimously upheld the decision of the High Court and concluded that the pre-April 2013 conditions applied to amendments to both future and past service.

It is not yet known whether the employer will appeal to the Supreme Court. The cost of the amendment being found to be void was assessed at around £10 million.

In the meantime, trustees and sponsors should consider what action should be taken in relation to any historic amendments made between April 1997 and 2016 - for example, whether to check if the appropriate actuarial confirmation was obtained. Sponsors will need to consider what disclosure obligations they may have for the purposes of their accounts or financial reporting.

A list of the key practical issues to consider is set out in our Virgin Media briefing.

Practical points:

- *Consider whether historic amendments in relation to the scheme need to be reviewed.*
- *If reviewing amendments, consider evidence required to conclude that confirmation was obtained, and practical implications for scheme benefits if it was not.*

DB FUNDING CODE

The Pensions Regulator has published the final version of its new code of practice on funding defined benefit schemes. The new code of practice will provide guidance on how trustees can comply with the new requirements to have a funding and investment strategy in place in relation to valuations with effective dates on or after 22 September 2024.

The Pension Schemes Act 2021 amended the Pensions Act 2004 to require trustees to have a funding and investment strategy (FIS) setting out the funding level the scheme should have achieved at the "*relevant date*" and the investments the scheme intends to hold on that date. Regulations also require the trustees to have a journey plan describing how the scheme will be fully funded at the point it reaches the relevant date. The FIS will require the consent of the employer where its consent is already required in relation to other funding documents. Otherwise, the employer will need to be consulted. The code of practice explains when consent is required and when consultation will be sufficient.

The code sets out the Regulator's interpretation of how to comply with the statutory funding requirements. However, whilst some provisions in the code reflect legal duties and are referred to as things that trustees "*must*" do, much of it is only the Regulator's view of what best practice is and the code says that trustees "*may choose to follow an alternative approach… provided they are satisfied that underlying legal requirements are met*". Therefore, trustees need to ensure that they have actuarial, covenant and legal advice on how the new requirements apply to them and what is appropriate for the circumstances of their particular scheme.

Some key points to note from the new code of practice include:

- **Significant maturity:** The "*relevant date*" for the purposes of the FIS is a date chosen by the trustees, not later than the end of the scheme year in which the scheme will reach "*significant maturity*". "*Significant maturity*" is defined in the code as when a scheme has a duration of liabilities of 10 years (or, in the case of a cash balance scheme, 8 years), calculated in accordance with a specified formula. The calculation must be carried out using an actuarial basis that is the same as the scheme's low dependency funding basis (see below), except for economic assumptions which must be chosen by reference to the economic conditions prevailing on 31 March 2023.
- **Investment:** The FIS must take into account the objective that, once a scheme reaches significant maturity, the assets required for full funding (but not any surplus) should be invested in a way that is highly resilient to short-term adverse changes in market conditions and no further employer contributions are anticipated. However, the code confirms that trustees "*are not required to invest in line with [this] low dependency investment allocation*" and gives examples of situations where the actual investment allocation may be different from the low dependency investment allocation, such as where there is a material surplus.

  The code sets out what a low dependency asset allocation might look like and how trustees can test resilience to market movements. The level of detail the Regulator expects depends on how close the scheme is to maturity - the closer it is, the more granularity is required. The code also looks at investment de-risking considerations as a scheme progresses along its journey plan.
- **Funding:** The FIS must follow the principle that the scheme should be fully funded at significant maturity on the assumption that no further employer contributions are made and the assets are invested in a low dependency investment allocation. The code says that trustees should assess whether this test would be met under most reasonably foreseeable scenarios but that they are not required to eliminate the requirement for further employer contributions with certainty, just to be satisfied that the likelihood of requiring them is small.

  The code sets out how the trustees should determine the assumptions to be used for the low dependency funding basis, including discount rates, inflation and mortality assumptions. Where there is no requirement under scheme

rules for employers to meet expenses, the Regulator expects there to be a reserve for expenses and encourages trustees to consider a reserve in other cases.

- **Employer covenant:** The level of risk that can be taken in actuarial assumptions used in the FIS and in the journey plan is dependent in part on the strength of the employer covenant. Regulations set out issues which must be taken into account in assessing covenant strength, including the employer's expected cash flow, the performance, future development and resilience of its business, and the likelihood of an insolvency event, as well as how long the trustees can be reasonably certain they can rely on an assessment of these matters.

  Trustees are expected to carry out a covenant assessment at each valuation as a minimum and they should document the approach taken and be able to justify why it is appropriate. For most employers, the code says that cash flow reliability will only be over the short to medium term (3 to 6 years) and covenant reliability will not exceed 10 years. However, some reliability periods may extend beyond this, based on specific circumstances.

  The code provides guidance on assessing covenant and the support provided by contingent assets and trustees will need to engage with covenant and legal advisers early on. In relation to contingent assets, trustees should identify when they will be called on and an appropriate method to assess their expected realisable value and guidance is provided on factors to take into account. Trustees "*should be satisfied that they have sufficient legal advice in relation to the enforceability of… contingent assets… They should then consider whether, on balance, taking into account any qualifications in the legal advice, if this supports taking additional risk*."

  Further draft guidance on covenant assessment is expected "in due course".

- **Trustees:** The code says that trustees "*should document their considerations and reasons for decisions and be in a position to be able to evidence and explain… all decisions made*". The Regulator may request to see documentation which is not formally required as part of the valuation process.

- **Open schemes:** The final version of the code allows greater flexibility for open schemes to take into account future accrual and new members when determining their maturity. There is also an acknowledgement that the scheme's actual long-term objective may not align with the low dependency target set out in the FIS, particularly where there is no intention of closing to new members or future accrual.

- **Statement of strategy:** A formal statement of the FIS will need to be submitted to the Regulator in a format to be determined by it. The Regulator has consulted on the form of the statement and says that it expects to publish the final version in the autumn. The code confirms that "*employers must provide trustees with information which the trustees and/or their professional advisers reasonably require*" for the purposes of completion of the statement of strategy.

- **Recovery plans:** A recovery plan must be appropriate, having regard to the nature and circumstances of the scheme. In determining this, trustees must follow the overriding principle that steps must be taken to recover deficits as soon as the employer can reasonably afford. However, the trustees are also required to consider the impact of the recovery plan on the sustainable growth of the employer. The code explains the factors that trustees should take into account when setting a recovery plan and what reasonable affordability means in this context.

The Regulator has also issued a response to consultation on its proposed "Fast Track" approach, along with details of changes it is making to that approach. The Fast Track is a prescribed valuation approach which, if used, will result in less detail being required in the statement of strategy and less engagement from the Regulator. The Fast Track parameters cover the low dependency funding basis, technical provisions, funding and investment risk and recovery plans, and contain some simplifications for smaller schemes. Recovery plans must be limited to 6 years where a scheme has not reached significant maturity, or to 3 years where it has. The scheme actuary will need to confirm that a scheme meets the Fast Track parameters, and more information will be given about this in a future document.

Finally, it should be noted that the code of practice is not yet in force as it will need to lie before parliament for 40 days. The summer recess period (from 30 July to 2 September) will not count for these purposes, so the code will not actually come into force until October. Although this means there will be a gap between the FIS requirements applying to schemes with valuation dates on or after 22 September 2024 and the code being in force, this is unlikely to present any problems in practice as the gap will be short and we know what the code says.

Practical points:

- *Identify the scheme's first valuation date to which the new requirements will apply and consider what the scheme's funding and investment strategy might look like.*
- *Begin to consider what information might be required for an assessment of covenant, as this is likely to be a fairly time-consuming process.*
- *Allow sufficient time for actuarial, covenant and legal advice in relation to the new regime.*

PENSION SCHEMES BILL

The King's Speech announced that there will be a Pension Schemes Bill in the current parliament which will include consolidation of small DC pots, value for money in DC schemes and default decumulation options, DB consolidation and confirmation that the Pensions Ombudsman is a "competent court" for certain purposes.

The proposed content of the Bill is not particularly surprising and mostly relates to proposals consulted on by the previous government. In particular, it will address:

- **Consolidation of DC pots:** In November 2023, the previous government confirmed that it intended to legislate to introduce a consolidation framework for small, deferred DC pots created within the auto-enrolment regime. Small pots for these purposes were pots where there had been no contributions for 12 months and which were valued at £1000 or less.
- **Value for money framework:** In 2021 the FCA and the Pensions Regulator issued a joint discussion paper on a framework and possible metrics to assess value for money across all DC schemes. The regulators and successive governments have remained committed to these proposals and the King's Speech says that the Bill will introduce "*a standardised test*" for occupational DC schemes to demonstrate they deliver value, which will also be implemented by the FCA in relation to personal pensions. It has previously been suggested that the test would require schemes to compare their performance, costs and other metrics against at least two other schemes managing over £10 billion.
- **Requiring schemes to offer DC retirement solutions:** In November 2023, a response to consultation was issued, concluding that legislation should require DC trustees to offer a service to members accessing benefits which provides decumulation options of an appropriate quality and price, including a default decumulation solution.
- **DB consolidation and superfunds:** Legislation to regulate superfunds has been under discussion for a number of years and should be included in the Bill. Pending the introduction of a statutory regime, the Pensions Regulator has issued guidance on the authorisation and supervision of superfunds and for trustees and employers looking to transfer to superfunds.
- **Pensions Ombudsman, a competent court:** In November 2023 the Court of Appeal confirmed that the Ombudsman is not a "competent court" for the purposes of statutory provisions allowing set-off against pension benefits. This means that if trustees wish to recover overpaid benefits by offsetting them against future payments and there is a dispute, they will need an enforcement order from the county court. The Bill will confirm that the Ombudsman is a competent court and remove this layer of administrative complexity.

The description of the Bill said that it was intended to "*enable pension schemes to invest in a wider range of assets, driving growth*". It is possible that legislation to address refunds of surplus in ongoing schemes could be picked up under this heading.

Practical points:

- *Watch out for a draft Pension Schemes Bill.*
- *Consider what any future proposals might mean for the scheme.*

PENSIONS REVIEW

The Chancellor has announced a pensions review which will, in its first phase, consider how assets in both the Local Government Pension Scheme and DC schemes could be invested in UK businesses. A second phase is planned later in the year which will consider member outcomes and how they can be improved.

The government believes that an "*investment shift in defined contribution schemes could deliver £8 billion of new productive investment*" into the UK economy and, in similar vein, says that action "*will be taken to unleash the full investment might of the £360 billion Local Government Pension Scheme to make it an engine for UK growth*".

A pensions review will be undertaken to consider how these aims can be achieved, and the measures in the new Pension Schemes Bill discussed above will form part of this initiative. The new Pensions Minister, Emma Reynolds, said "*Over the next few months the review will focus on identifying any further actions to drive investment that could be taken forward in the Pension Schemes Bill before then exploring long-term challenges to ensure our pensions system is fit for the future… There is so much untapped potential in our pensions markets, with an industry worth around £2 trillion.*" Work will be led jointly by the DWP and the Treasury, which is unusual, as pension reform is generally led by DWP.

Beyond greater consolidation in both the DB and DC spheres, there is little indication of how the government intends to achieve its stated objectives. Schemes can already invest in the majority of asset types, with restrictions in place largely to limit investment in sponsoring employers (to protect assets in the event of employer insolvency) and to ensure that portfolios are properly diversified, members' interests are considered, and trustees consider the security, quality, liquidity and profitability of the portfolio as a whole. These qualifications are intended to protect members, so careful consideration would be needed before any steps were taken to allow investment without regard to them.

There will be a second phase of the review, due to start later this year, which will consider "*further steps to improve pension outcomes and increase investment in UK markets, including assessing retirement adequacy*". It is not clear from the announcement what this second phase will cover, though the mention of "*retirement adequacy*" could indicate possible changes to the auto-enrolment regime.

***Practical points*:**

- *Watch out for further publications in relation to what the review will cover.*
- *Be aware of general policy intention to increase investment of pension assets in UK industry.*

COURT OF APPEAL ON MEANING OF "INTERESTS" IN AMENDMENT POWER

In the recent case of BBC v BBC Pensions Trust Ltd, the Court of Appeal considered a fetter in an amendment power which restricted amendments that affected the "interests" of active members. The Court concluded that "interests" in this context was not limited to accrued rights and could include future service benefits.

The amendment power gave the trustee power to amend the scheme with the consent of the employer and subject to a number of restrictions or fetters. One fetter provided that no alteration could take effect in relation to active members "*whose interests are certified by the Actuary to be affected*" unless certain criteria were fulfilled, which were broadly designed to ensure that such interests were not substantially prejudiced.

The employer asked the Court how the amendment power should be interpreted and whether it could be used to change future service benefits for active members or increase their contributions. The High Court concluded that "interests" in this context should be interpreted widely and included the ability of members to accrue future service benefits (which meant it extended to closing the scheme to future accrual). The employer appealed.

The Court of Appeal upheld the decision of the High Court.

The Court of Appeal also adopted a wide construction of the meaning of "*interests*" and held that it was "*a deliberately simple, broad and open-textured word. Unlike other examples of fetters on powers of amendment… it is not tied to "rights"; still less to rights that have "accrued" or been "secured". Nor is it limited by reference to any particular cut-off date. Nor is there any limitation by reference to "past contributions" or "contributions already made"."* One of the most

valuable interests an active member has is the ability to continue to accrue benefits and "*if one asks whether an Active Member has an interest in future service accrual, the answer would be yes*".

Whilst the Court had sympathy with the argument that the employer had power to freeze the scheme and prevent future accrual through the termination provisions, which therefore suggested it was illogical to interpret the amendment power as preventing amendments to future service rights, it concluded that there were differences between the circumstances in which the two powers could be exercised and "*whatever may or may not be envisaged about scheme cessation [did] not tell you much about amendment of an ongoing scheme*".

The Court also held that the word "*interest*" was context-dependent and did not have to mean the same thing at each place it was used in the Scheme rules.

***Practical points*:**

- *Check if rules contain a restriction by reference to members' "interests".*
- *If yes, consider impact of decision on operation of that restriction.*

AUTO-ENROLMENT DECISIONS

The First-Tier Tribunal has recently considered a number of cases concerning fines from the Pensions Regulator in relation to employer breaches of auto-enrolment duties. The decisions suggest that there is a growing expectation that the Regulator should ensure a pragmatic and proportionate approach to using its powers to fine employers.

Employers have statutory duties to auto-enrol employees who meet age and earnings criteria into a scheme that also meets minimum criteria. Most employers use DC schemes to satisfy their auto-enrolment duties and generally, employer and employee contributions must equal 8% of the member's earnings between £6,240 and £50,270, with the employer paying contributions of at least 3%. An employer is required to complete a declaration of compliance within 5 months of first becoming subject to the auto-enrolment obligations, giving prescribed information about how it has complied with them. Where an employer does not comply with its auto-enrolment obligations, the Regulator has a discretion to impose fines, ranging from a £400 fixed penalty to an escalating penalty varying from £50 to £10,000 per day.

In a number of recent cases, employers successfully appealed the imposition of auto-enrolment penalties:

- In *Cofal v Pensions Regulator,* a small employer became subject to auto-enrolment duties on 6 May 2023. It complied with its duties except for the requirement to submit a declaration of compliance. Having sent an initial reminder letter in July, the Regulator issued a compliance notice on 1 November 2023, followed by a fixed penalty notice of £400 on 29 December 2023. The owner appealed. The Regulator argued that it was "not plausible" that the employer was unaware of its obligations in relation to the declaration of compliance and it was "irrelevant" that other auto-enrolment duties had been complied with. The tribunal disapplied the penalty notice and remitted the matter to the Regulator, concluding that it would have been "*bizarre*" for the employer to delay filing the statement of compliance if it had understood the requirements. In addition, although the duty to file a declaration was a significant means of enabling the Regulator to confirm compliance, "*the Regulator should maintain a sense of proportion and not indulge in overblown rhetoric which denigrate[s] the purpose for which it was created*".
- In *Giannis Glasgow Ltd v Pensions Regulator* the Regulator had contacted the employer's former accountant several times in relation to auto-enrolment breaches and, receiving no response, imposed first fixed and then escalating penalties. The first notice the employer actually received was a notice to his personal email address stating that £14,400 of penalties had been incurred. He immediately responded and asked for a review, which the Regulator declined. The tribunal held that the employer was responsible for notifying the Regulator he had changed accountants and therefore the £400 fixed penalty would stand. However, the point of an escalating penalty was that it acted as an incentive, and there could be no incentive where there was no effective communication. In addition, a proper consideration of the circumstances of the breach, including the lack of intent, the failure of the Regulator to use all available means of communication and the absence of harm to employees meant that the impact of the escalating penalty was "*wholly disproportionate and oppressive*".

- Finally, in *Cambridge Rare Books v Pensions Regulator,* the employer failed to pay contributions for several months and the Regulator issued a notice requiring payment by a specified date. The employer failed to comply with this and two further deadlines, and fixed and then escalating penalty notices were issued. Eventually, the employer requested a review on the basis that a director had been very unwell, the business had been going through a very difficult time and that they would pay the unpaid contributions by paying one month's unpaid contributions every month going forward. The Regulator extended the deadline for paying the contributions by just over a month and the employer appealed. The tribunal upheld the fixed penalty notice, as illness and financial difficulties were not a reasonable excuse for not paying pension contributions. However, in relation to the escalating penalty notice, having been told that the employer had recognised its default, attempted to agree a payment plan and resolved to pay off an amount per month, it was not reasonable or proportionate to set a date for compliance that did not allow time for that reasonable proposal to be put into operation.

Whilst all three of these cases relate to small employers, there are lessons to be learned for other employers and trustees. The Regulator holds itself out as a proportionate and risk-based regulator and it seems that the First-Tier Tribunal expects it to act in a manner consistent with that (and will hold it to account if it does not). This means that if penalties are imposed and parties are aware of mitigating factors, at the very least they should ensure that they are pointed out to the Regulator and related back to its aim of acting in a proportionate way. Also, if an escalating penalty is imposed, consideration should be given to whether the penalty can properly be regarded as an incentive to behave in a compliant way or if there are factors which mean that it cannot operate as an effective incentive.

Practical points:

- *Employers and trustees should be aware of the Regulator's enforcement policy, which sets out the factors that should determine its approach to enforcement action.*
- *Consider whether any use of Regulator powers is in line with this and with the principles in recent decisions.*

WATCH LIST

For upcoming developments see our new pensions horizon scanning webpage.

No	Topic	Effective date or expected effective date	Further information/action
1	Changes to DC scheme governance and disclosure	2024/25	Anticipated that wording for new value for money framework in occupational pension schemes will be included in a new Pension Schemes Bill. Draft legislation on consolidating small DC deferred pots also expected in the Bill, along with new obligations in relation to decumulation options.
2	DB consolidation	2024/25 Public consolidator to be established by 2026, consultation on features closed on 19 April 2024.	TPR updated interim guidance - issued August 2023. Draft legislation on superfunds expected in Pension Schemes Bill.
3	Changes to pensions tax allowances	Lifetime allowance removed on 6 April 2024 and two new tax-free cash allowances introduced.	Further amending regulations expected in 2024/25.
4	Repayment of surplus	The reduction in the tax charge took effect on 6 April 2024. Consultation closed on 19 April 2024.	Tax charge on repaying surplus reduced from 35% to 25%. Consultation has closed on facilitating repayment of surplus in ongoing schemes. There is no reference to legislation being included in any forthcoming Bill.
5	Funding and investment strategy requirements for DB schemes	Legislation came into force 6 April 2024. Funding and investment strategy in place 15 months from date of the first valuation obtained on or after 22 September 2024. Revised Code of Practice from TPR will come into force in October 2024.	Consultation on covenant guidance expected later in 2024. TPR has consulted on the form of the strategy statement and final form still awaited.

No	Topic	Effective date or expected effective date	Further information/action
6	Notifiable events for DB schemes on corporate and financing activity	Significant uncertainty about publication of government response to consultation on draft Notifiable Events (Amendment) Regulations.	TPR will consult on update to Code of Practice 2 (Notifiable Events) and accompanying guidance once DWP have published their finalised regulations and consultation response.
7	Pensions dashboards	Compulsory connection deadline of 31 October 2026 for schemes with 100 or more active and/or deferred members at year end between 1 April 2023 and 31 March 2024; staging timetable set out in DWP guidance. Application for deferral (in limited circumstances existing at 9 August 2023) must be made by 8 August 2024.	All registrable UK-based schemes with active and/or deferred members.
8	Corporate transparency	The Economic Crime and Corporate Transparency Act 2023 introduces requirements on identity verification, corporate directors and limited partnerships. The requirement to have a registered email address and for registered offices to meet certain requirements came into force on 4 March 2024. Other provisions are due to come into force later in 2024.	All corporate trustees and schemes using Scottish Limited Partnerships. More detail about what the Act requires can be found in our briefing.

London
T +44 (0)20 7600 1200
F +44 (0)20 7090 5000

Brussels
T +32 (0)2 737 94 00
F +32 (0)2 737 94 01

Hong Kong
T +852 2521 0551
F +852 2845 2125

Beijing
T +86 10 5965 0600
F +86 10 5965 0650

Published to provide general information and not as legal advice. © Slaughter and May, 2024.
For further information, please speak to your usual Slaughter and May contact.

www.slaughterandmay.com

586774093