STEPHENSON HARWOOD
pensions law group

Snapshot

May 2023

Overview

- Changes to lifetime allowance
  Following the changes to the Lifetime Allowance (**LTA**) regime effective from 6 April 2023, we have some more clarity on how these changes will operate in practice and in particular the impact on (i) accrual for persons with enhanced and fixed protection; (2) the continued value of these protections; and (3) the continued testing against the LTA of lump sum payments.

- Pension scheme and LDI
  The Bank of England's Financial Policy Committee (**FPC**) has recommended that the Pensions Regulator (**Regulator**) takes action as soon as possible to mitigate financial stability risks by specifying the minimum levels of resilience for the Liability Drive Investment (**LDI**) funds in which pension scheme trustees can invest. On the back of the FPC's statement, the Regulator has issued guidance on practical steps trustees should be taking to manage risks when using leveraged LDI. This includes a requirement that, in general, an LDI arrangement should have a market stress buffer of **at least 250 bps.**

- The Regulator issues guidance on improving equality, diversity and inclusion amongst trustees
  The Regulator has issued guidance to trustees and employers to improve equality, diversity and inclusion (**EDI**) in the appointment of trustees. Many schemes may be reviewing their policies and appointment processes as part of their general code of practice compliance review. It may therefore be the optimum time to consider EDI and ensure that any policies are updated to take into account the Regulator's expectations in this area.

- The Regulator's corporate plan for 2023-2024
  On 21 April, the Regulator published its Corporate Plan for 2023 to 2024 (**Plan**). Of particular significance is the confirmation in the Plan that the defined benefit funding code will now be delayed from October 2023 until April 2024.

- PASA'S new dashboard guidance
  PASA has published two new pieces of dashboard guidance which covers:
  - what administrators, providers and service centres should say to savers who enquire about dashboards before they become universally acceptable; and
  - an important addition to the PASA Data Matching Convention Guidance last updated in August 2022.

- The Regulator undertakes new initiative to check savers are getting value from their pensions
  The Regulator is undertaking a new initiative to check savers in defined contribution (**DC**) schemes are benefitting from new rules that require trustees to assess whether they are delivering value for their members. Under the initiative, the Regulator will be checking that trustees of DC schemes with assets under management of less than £100m are complying with new value for member regulations that came into force in October 2021.

- Regulator guidance on employer related investments
  The Regulator has published new guidance reminding trustees and employers of the restrictions around using scheme funds for employer related investments and the risk of criminal sanctions.
  This guidance reminds trustees that not more than 5% of the market value of pension scheme assets may be invested in employer related investments (**ERIs**).

- Why trustees must be ready to step up on ESG and climate reporting
  A blog has been published by the Regulator emphasising the importance of trustees complying with their environmental, social and governance (**ESG**) and climate reporting duties in 2023. This in particular applies to trustees of schemes with 100 or more members who have certain reporting and publication obligations.

In more detail

Changes to the Lifetime Allowance

Following the changes to the LTA regime effective from 6 April 2023, we have some more clarity on how these changes will operate in practice. There are three areas in particular which are impacted by the changes:

- Accrual for persons with protection – individuals with enhanced or fixed protection in place on 15 March 2023 can recommence pension accrual should they wish without jeopardising their protection;
- Continuing need for protections - Despite the removal of the LTA tax charge on excess savings over the LTA, enhanced and fixed protections remain valuable because of the access these protections give to increased tax-free lump sums; and
- Tax charges on lump sums - testing against the LTA for serious ill-health lump sums or a defined benefit lump sum remains necessary. The value of such payments in excess of the LTA will be subject to income tax at the recipient's marginal rate.

Please see our briefing on this topic for more detail on these areas.

Pension schemes and LDI

In our March snapshot we discussed how the Bank of England had given clear indications that it wanted increased regulation over the use for LDI by pension schemes. In its Financial Policy Summary and Record, the Bank of England's FPC re-iterated that there is an urgent need for non-bank financial institutions to have more resilience. In particular, LDI funds need to be able to withstand severe plausible stresses in the gilt market. As a result, the FPC recommended that the Regulator takes action as soon as possible to mitigate financial stability risks by specifying the minimum levels of resilience for LDI funds in which pension scheme trustees can invest. LDI funds should be resilient to a yield shock of 250 basis points at a minimum as well as the resilience required to manage other risks and day-to day movements in yields.

On the back of the FPC's statement, the Regulator has now issued guidance on practical steps trustees should be taking to manage risks when using leveraged LDI (that is, LDI that requires collateral to be provided to counterparties as security).

The Regulator reminds trustees that the investment of scheme assets remains ultimately the responsibility of the pension scheme trustees. Trustees must ensure they have robust processes in place to ensure their scheme is resilient to market shocks. There are four main areas trustees need to consider:

- Investment strategy – trustees should review their investment strategy on a regular basis as well as where there have been significant changes to the scheme's circumstances or market conditions. Trustees should consider the advantages and disadvantages of LDI in the wider context of the scheme. Whilst LDI is useful for managing volatile funding deficits, trustees must be aware that it will require the scheme to maintain a certain level of liquidity to meet collateral calls.
- Collateral resilience – trustees should ensure that any LDI arrangements they are invested in are resilient to short-term adverse market changes. The Regulator notes that in addition to the operational buffer operated by the LDI fund, an LDI arrangement should also have a market stress buffer of **at least 250 bps.**

- Governance – trustees need to understand the role and responsibilities of their advisers in respect of LDI and ensure that the level of delegation and monitoring is appropriate and set out clearly in service contracts.
- Monitoring – trustees should also ensure processes are in place for monitoring the resilience of the LDI arrangement.

This guidance reminds trustees of the importance of their investment obligations. If trustees are invested in, or considering investing in, LDI, they will need to ensure they understand both the benefits and risks involved at the outset and on an ongoing basis. The Regulator clearly expects trustees to keep this under consideration and ensure that such investments remain appropriate for the scheme. Trustees should ensure that they clearly document the decisions they make around LDI investment as evidence that a proper process and appropriate consideration has been undertaken.

The Regulator issues guidance on improving equality, diversity and inclusion amongst trustees

The Regulator has issued guidance to trustees and employers to improve EDI in the appointment of trustees.

The Regulator recommends that:

- trustees keep up to date with training on EDI;
- trustees develop and maintain an EDI policy covering an agreed definition of EDI, the EDI aims of the trustees and an EDI training plan;
- the chair of trustees should play a key role in promoting EDI;
- any performance assessment of the trustees or advisory firms should include how well EDI is and continues to be embedded into processes;
- the trustees should set out EDI objectives and goals at the start of the scheme year;
- trustees should review how they consider EDI is being embedded into meetings;
- when employers are appointing trustees, they should consider widening the pool of candidates to include those outside of senior management positions;
- diversity amongst the trustees should be reviewed and any gaps identified;
- an inclusive culture amongst the trustees should be encouraged;
- EDI should form a key part of the recruitment process for new trustees and recruitment processes may need to be amended to attract a wider variety of candidates. The guidance provides examples of methods that can be employed to attract a greater range of trustees; and
- when appointing advisers and service providers, trustees should consider how they can promote inclusive discussion and decision making. The Regulator provides a number of questions that trustees can include in tenders for providers and advisers regarding EDI.

Many schemes may be reviewing their policies and appointment processes as part of their general code of practice compliance review. It may therefore be the optimum time to consider EDI and ensure that any policies are updated to take into account the Regulator's expectations in this area.

The Regulator's corporate plan for 2023-2024

On 21 April, the Regulator published its Corporate Plan for 2023 to 2024.

Whilst the Plan emphasises the preparation for the new DB funding code, it also notes that the funding code will now be delayed from October 2023 until April 2024.

The Plan also indicates that the Regulator will significantly increase its focus on the quality of outcomes in DC schemes. This Plan details the activities that will deliver this change.

The Plan pursues five strategic objectives, being:

- Security: Savers' money is secure.
- Value for money: Savers get good value for their money.
- Scrutiny of decision-making: Decisions made on behalf of savers are in their best interests.
- Embracing innovation: The market innovates to meet savers' needs.
- Bold and effective regulation: The Regulator is a bold and effective regulator.

The industry considered that the initial timeframe for the funding code was ambitious. Against a backdrop of discussions over the role that the Regulator should take regarding the supervision and regulation of pensions schemes and their use of LDI, it is perhaps not surprising that this has been pushed back.

PASA'S new dashboard guidance

PASA has published two new pieces of dashboard guidance.

The guidance covers:

- what administrators, providers and service centres should say to savers who enquire about dashboards before they become universally acceptable; and
- an important addition to the PASA Data Matching Convention (DMC) Guidance last updated in August 2022.

The guidance is intended to provide assistance in terms of responding reactively to member queries about dashboards whilst they are being phased in as a concept.

The addendum to the DMC Guidance covers two key areas: (1) matching without a National Insurance Number; and (2) guidance on Possible Match responses (i.e. the response to be provided where not all member data matches up to the matching criteria and therefore there is uncertainty over whether the individual is in fact a member of the scheme).

PASA is hopeful that these two new pieces of guidance will help to support the industry in preparing to deliver pensions dashboards.

The Regulator undertakes new initiative to check savers are getting value from their pensions

The Regulator is undertaking a new initiative to check savers in defined contribution schemes are benefitting from new rules that require trustees to assess whether they are delivering value for their members.

Under the initiative, the Regulator will be checking that trustees of DC schemes with assets under management of less than £100m are complying with new value for member regulations that came into force in October 2021.

The Regulator has stated that it will take a data-led approach in order to contact selected schemes about their value for member assessment, including those that have indicated they have failed the assessment. The Regulator will then check that trustees have plans in place to improve their assessments.

The Regulator notes that where improvements in compliance cannot be evidenced, the Regulator will ultimately expect trustees to wind up and consolidate into what it considers to be a "better run" scheme.

Regulator guidance on employer related investments

The Regulator has published new guidance reminding trustees and employers of the restrictions around using scheme funds for employer related investments and the risk of criminal sanctions.

This guidance reminds trustees that not more than 5% of the market value of pension scheme assets may be invested in ERIs. Furthermore, it reiterated that certain types of ERIs are absolutely prohibited, such as transactions at an undervalue and loans or guarantees to any employer. The guidance lists out these types of ERIs and explains the consequences of breaking the rules, including a £5,000 fine for individuals and £50,000 for companies, or imprisonment (or both). It also reminds trustees, employers and scheme advisers of their additional duties, such as:

- to report ERI breaches to the Regulator; and
- disclosing details in the annual report.

The Regulator felt that additional guidance was required because of an increasing number of recent cases involving ERI. These included the trustees of the Focusplay Retirement Benefits Scheme, the former owner of Norton Motorcyles Limited, and two directors of Eastman Staples Limited. In each case, the trustees had made prohibited employer-related investments or loans and the sentence was a custodial sentence or suspended custodial sentence plus repayment to the scheme.

Why trustees must be ready to step up on ESG and climate reporting

A blog has been published by the Regulator emphasising the importance of trustees complying with their ESG and climate reporting duties in 2023.

The Regulator will check that trustees of schemes with 100 or more members have published a statement of investment principles (**SIP**), which details the policies for how a scheme invests, including consideration of financially material ESG factors. These trustees must also publish an implementation statement (**IS**) which shows how the principles in the SIP have been implemented.

The Regulator expects to see compliance in this area improve and is warning trustees with in-scope schemes that enforcement may be taken for failing to publish their SIPs and/or IS.

In relation to climate change, the Regulator wants to see trustees of all in-scope schemes publish their annual climate change report and to provide the web address for that report in their scheme return. Further it expects trustees to have regard to the Department for Work and Pension's (DWP) guidance and report on a new portfolio alignment metric and, where trustees are reporting for the second time, consider scope 3 emissions.

The Regulator reminds trustees that where there is a failure to comply with the publication requirement, it must impose a mandatory penalty. The minimum is £2,500 and the maximum is £50,000 (where the trustee is a corporate body).

The Regulator emphasises that more focus on outcomes with regards to climate change is crucial and suggests trustees consider developing a climate action plan setting out what actions (if any) they expect to take and when.

Our wider team – a closer look

A spotlight on...employment

Stephenson Harwood's employment team provides comprehensive legal services, making it a go-to legal advisor for wide variety of clients across numerous sectors, including those with pension-related concerns. Our services span all aspects of employment law, including advice on employment contracts, policies and procedures, general human resources queries, as well as more contentious issues like workplace disputes, discrimination claims, whistleblowing and dismissals. Our litigation practice has appeared before the Employment Tribunal, Employment Appeal Tribunal, High Court and Court of Appeal in a number of complex cases.

The employment team works closely with the pensions team on a variety of issues. From ensuring pension arrangements for individuals are properly documented on both entry and exit from a business, to working cohesively on the employment and pension implications of corporate deals, in particular where there is a transfer of employees. Changes to pension arrangements may necessitate communications and consultation with employees, and changes to employment documentation. A failure to implement these changes properly can lead to disputes. Likewise, the employment team's experience in discrimination claims can be invaluable in advising on how to deal with tricky issues such as pensions during maternity or other family friendly leave and death in service benefits. The employment team advised a multinational luxury brand on the complex issues arising for an employer in relation to employer pensions contributions during paid and unpaid periods of maternity and shared paternal leave. Our advice considered how the position differs where there is a salary sacrifice arrangement for pension contributions in place. The level of technical detail required from both the employment and pension specialisms demonstrates our ability to work together across practice areas to deliver expert advice.

Moreover, Stephenson Harwood's employment team is well-positioned to provide strategic advice in the event of business changes such as redundancies or restructuring, including the obligation to consult with employees, which can have significant implications for pension schemes. With our extensive experience and proactive approach, we can help clients navigate these complex issues, ensuring compliance with legal requirements and mitigating risk. Whether it's routine advice or complex litigation, pensions clients can rely on Stephenson Harwood's employment team to deliver the legal support they need.

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