SLAUGHTER AND MAY/

PENSIONS ESSENTIALS

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

VIRGIN MEDIA DISCLOSURES IN ACCOUNTS

As the industry continues to grapple with the ramifications of the decision in Virgin Media in relation to the validity of amendments to formerly contracted-out schemes, guidance has been issued for auditors in relation to how to address potential issues in sponsor accounts.

Between 6 April 1997 and 6 April 2016, schemes could contract members out of the second tier of the state pension on a "reference scheme test" basis. The actuary needed to certify that a scheme continued to meet this test every three years and, generally, when amendments were made, provide confirmation that it was still satisfied. In July 2024, the Court of Appeal confirmed that where the required confirmation was not obtained in relation to pre 6 April 2013 amendments, amendments would be void.

This has resulted in schemes doing reviews of historic amendments and it is clear that actuarial confirmations cannot now be found in all cases. This is causing considerable uncertainty and as reported in Pensions Essentials last month, the industry continues to ask the government for regulations to deal with the issue. There is also a further case being heard by the court which may consider evidential issues in relation to missing confirmations.

In the meantime, if an amendment is found to be void, this could potentially increase scheme liabilities and the potential cost to sponsors. This means that auditors of both scheme and sponsor financial statements are having to consider the impact (if any) of the decision.

The Institute of Chartered Accounting for England and Wales has issued guidance for auditors on the case. It envisages that trustees will have adopted one of three approaches:

- **Wait and see:** This may be appropriate where, for example, there is no reason to think that historic deeds lacked the required confirmations and/or mounting a full investigation would be costly. The guidance points out that this approach does not mean that trustees do not need to do anything.
- **Information gathering:** Trustees could obtain a fuller picture about whether there is a potential issue. This approach is scalable depending on the circumstances of the scheme and may, for example, involve identifying which deeds amended reference scheme test benefits as they are the only ones for which confirmation would be required.
- **Detailed analysis:** Detailed consideration would be given as to whether the scheme is paying the correct benefits and what scheme liabilities should be. There is an acknowledgement that trustees may "*conclude that it is not a prudent use of scheme resources to perform a detailed assessment while so many uncertainties remain*" and that most trustees are unlikely to go down this route for the moment.

Whatever the approach, sponsors need to consider how to present the potential impact of the case in their financial statements. The guidance suggests three potential accounting treatments:

- **Not recognise any amounts or make any disclosure** - This might be appropriate where a scheme was never contracted-out on a reference scheme test basis, investigations have shown there is no problem or the size of the scheme is immaterial to the size of sponsor. It may be challenged by auditors and should be discussed with them in advance.
- **Disclose potential implications of the case in the pension note but not recognise any amounts** – As most trustees will not have completed a detailed assessment, it is unlikely to be clear how DB liabilities might change and whether they need to be reassessed. In these circumstances, it might be appropriate to make a disclosure around the additional uncertainty over the measurement of the DB obligation which is specific to the circumstances of the scheme and sponsor.
- **Remeasure the DB obligation and recognise a change** - It is unlikely that enough information will be available to quantify any impact on the DB obligation while investigations are ongoing as this would require detailed legal, actuarial and data analysis. If this has been completed, sponsors will need to consider whether and how to recognise any change within their financial statements. Consideration would then need to be given as to the correct accounting treatment and a prior year adjustment may need to be made, as the scheme liabilities would have been historically misstated.

Sponsor auditors will need to make judgements about the approach that needs to be taken depending on the specific circumstances of the scheme. Early communications with sponsors will be important who, in turn, should be in touch with trustees. The guidance confirms that where it is expected that schemes will be affected by Virgin Media, it may not yet be possible to tell how material any impact could be.

Three potential options are identified for auditor's reports:

- **No impact** – This is likely to apply in most scenarios. It would be the case where, for example, scheme liabilities are immaterial or Virgin Media may apply and trustees have not completed their investigations but the auditor concludes that the potential effect of the ruling has been appropriately reflected.

  If the auditor considers that the financial statements do not adequately reflect the issues raised by Virgin Media, the first step is to discuss their concerns. The trustees or sponsor may be able to provide additional justification to support their choices or may conclude that further action, recognition or disclosure is appropriate and adjust the financial statements accordingly.
- **Wording in report to draw attention to issue** - An Emphasis of Matter paragraph can be included in an audit report to draw attention to a matter that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements. This would only be expected to be necessary in limited circumstances where the pension scheme liability is highly significant and, for example, the scheme has made significant amendments that could create a material future issue, but the auditor doesn't feel that the disclosure in the pension note is sufficiently prominent for users to understand the importance of the issue.
- **Issuing a qualified opinion due to a lack of available information** - A modified opinion is issued if the auditor concludes that the financial statements are not free from material misstatement or is unable to obtain sufficient evidence to confirm this. A qualification might be likely where, for example, information suggests a potential material impact on the scheme but no legal advice has been sought. Alternatively, there may be cases where insufficient information has been provided for the auditor to meaningfully evaluate the disclosures in the financial statements. However, issuing a qualified audit report may not be proportionate unless it seems probable that a scheme will have additional material liabilities and given current uncertainties, this is a high bar.

Practical points:

- *Be aware of auditor focus on the issue.*
- *Agree with the trustees what information can be shared with the auditors.*

AN ARCADIAN APPROACH TO SURPLUS

Surplus continues to be in the news with a recent High Court case concluding that amending scheme rules to allow the transfer in of another scheme to make use of surplus could be a proper use of an amendment power.

The High Court was recently asked to consider an arrangement to allow an executive scheme to be transferred in to another scheme to allow the underfunded executive scheme to benefit from the surplus in the receiving scheme.

The trustee of the Arcadia Group Pension Scheme (the "**Staff Scheme**") wanted to make use of its surplus by amending the rules to permit the transfer in of the underfunded Arcadia Group Senior Executives Pension Scheme (the "**Executive Scheme**"). Both schemes were in wind-up.

Background: The two schemes had always been operated together, sharing administrators, professional advisers and a joint funding and investment committee. The Executive Scheme was referred to as the Staff Scheme's "sister scheme".

In 2019, both schemes entered a PPF assessment period. A scheme rescue was agreed with the PPF and the Pensions Regulator which resulted in various security arrangements being put in place and £100 million being made available to be split between the schemes. Given the relative funding positions of the two schemes at the time, the whole of the £100 million was paid to the Staff Scheme as well as 85% of the amounts from the security arrangements. However, in 2022, the funding position of the schemes reversed. Buy-ins were completed and all of the Staff Scheme's liabilities were secured, but only 87% of the Executive Scheme's liabilities were secured. Merger would result in "*a surplus to be shared amongst all beneficiaries*".

When both schemes were closed to future accrual in 2010, a provision was included in the Staff Scheme rules which provided that " *No transfer of assets may be accepted into the Fund from any other pension scheme*." The Staff Scheme trustee sought to determine whether amending the scheme rules to remove this restriction would be a proper use of the very wide amendment power.

Decision on scope of amendment power: Once a winding-up of the Staff Scheme had been triggered, the rules provided that the amendment power vested solely in the trustee. The amendment power contained no express restrictions. In addition, the rules provided that the main object of the Scheme was to provide the benefits set out in the rules and that on wind-up, if the employer was insolvent, the trustee had a unilateral discretion to augment member benefits.

The court concluded that there was no reason a restriction should be implied into the amendment power. Whilst it might be unusual to amend a scheme in wind-up, the power of amendment was expressly preserved in these circumstances and it "*was intended to be both wide and flexible [and there was]… no reason to consider that it was intended to have a more limited scope when exercised solely by the trustee.*"

Decision on proper exercise of powers: The court also had to consider whether adding beneficiaries to the Staff Scheme would be outside the proper exercise of the power of amendment because it affected beneficiaries who had a contingent interest in a potential discretionary augmentation from a surplus, which would be diluted if the merger went ahead.

The court held that whether a proposed exercise of an amendment power is beyond its proper purpose falls to be determined by considering the rules and "*looking at the instrument as a whole in its context*". The relevant context included the history of a scheme because a review of the exercise of an amendment power should not just look at the scheme in its last iteration but also how the power had been used to create the scheme in its current form.

The key elements for the court to consider included the unrestricted nature of the amendment power, that the object of the Staff Scheme could be achieved notwithstanding the merger, the close relationship between the two schemes and the shared objective of both schemes to achieve a surplus. On this basis, the proposed amendment was a proper use of the amendment power.

Trustee's decision-making process: Only one director of the Staff Scheme Trustee was not either a director or member of the Executive Scheme and so did not have a conflict of interest.

Board minutes showed the factors this director had taken into account when deciding to amend the Staff Scheme, including what was fair and equitable in all the circumstances. The court concluded that the sole trustee director had reached a balanced decision that was objectively justifiable. It had been entirely proper to take account of what was fair and equitable in all the circumstances and this included a consideration of the fact that the funding arrangements for the two schemes had been managed with a view to achieving equality between them and the only reason why that had not been achieved was because of unforeseen circumstances.

Wider application: Confirmation that merging one DB scheme into another to make use of surplus can be a proper use of powers in some circumstances is likely to be welcome to trustees and sponsors alike.

However, reliance on this case should be approached with caution as the background facts and close relationship between the schemes was unusual. The Staff Scheme had received almost all of the money intended to be made available to both schemes because of its funding position at the time. Had the distribution of the rescue package been less one sided, the Executive Scheme may not have subsequently become underfunded.

Other factors that might distinguish this case are the wide and unfettered amendment power and the fact that the objects of the scheme were specifically stated in the trust deed.

Other surplus developments: Whilst on the subject of surplus, in last month's Pensions Essentials, we reported on the Government's announcement that it intends to move forwards with legislation to "*give businesses more flexibility, allowing trapped surplus funds to be invested into the wider UK economy, or given to scheme members as additional benefits*", although no details were actually given as to how this might work in practice and what any statutory provisions might actually say.

The Work and Pensions Committee recently confirmed that they are continuing to investigate the number of DB schemes that provide discretionary increases in relation to pre April 1997 service (on which there is no statutory entitlement to increases except in relation to GMPs). Apparently, the Pensions Regulator is planning to publish this information in the Spring. It is possible that the Government might choose to require ongoing surplus to be used to provide additional pension increases before any refunds to employers can be made.

Practical points:

- *Watch out for further statutory developments.*
- *Remember to consider the purpose of any power when considering a distribution of surplus.*

OMBUDSMAN DETERMINATION ON MIRROR IMAGE BENEFITS

A recent Ombudsman determination considered a promise to provide a member with mirror image benefits on a transfer to a new employer. The benefits had been detailed in numerous communications but were not reflected in the rules of either the transferring or receiving scheme.

This press release accompanying the determination says that it "*provides important lessons for pension schemes about the importance of properly documenting benefits promised on transfers in and on scheme mergers*".

Facts: H joined the scheme in 1981 and became entitled to executive benefits in 1989. The executive booklet said that members would receive increases of RPI capped at 5%, although it contained provisions saying that the booklet did not override the scheme rules and the increases were not reflected in the rules. Under the rules, increases were paid "*at such percentage rate per annum compound as may be fixed from time to time by [the Trustees at the direction of] the Principal Employer*".

In 1996, H's employment was transferred as a result of a reorganisation. A bulk transfer was proposed to the new employer's scheme. H was the only executive transferring and was told that the new scheme would mirror his benefits in the transferring scheme. H left service in 1998 and retired in 2014.

In 2015, the trustees received advice that the increases generally being paid to members were incorrect and did not reflect the rules and pensions would be frozen until they had reached the correct level.

H complained that he had a right to increases of RPI capped at 5% in the original scheme and this transferred to the new scheme. The employer argued that the rules had never reflected this and H had no contractual entitlement to it.

Determination: The Ombudsman determined that:

- There was a contract between H and the employer to provide the promised mirror image benefits in the receiving scheme. Even though this was never reflected in the scheme rules, all the elements of a contract - offer, acceptance, consideration and intention to create a binding agreement were present.
- The employer's commitment to procure mirror benefits in the new scheme was a continuing contractual obligation and was only breached when it finally confirmed in 2017 that it would not pay the promised increases. As H complained to the Ombudsman within 3 years of that confirmation, there was no limitation issue. In addition, as the appropriate remedy was for the employer to "specifically perform" the contract and pay the promised increases (as opposed to the payment of damages for breach of contract), limitation periods were not relevant as they did not apply to specific performance.
- The employer had breached the implied duty of good faith not to destroy or seriously damage the relationship of trust and confidence between an employer and a scheme member.
- The employer and H had acted on an agreed assumption that H would receive specific benefits in the new scheme and that this would be documented in due course. Both parties had conducted their relationship on the basis of this continued assumption so the employer was "estopped" from denying the assumption was correct.
- The transfer-in power in the new scheme gave the trustee discretion to determine the basis of benefits to be provided so it could not argue that it had no power under the scheme rules to provide the agreed benefits.
- The transferring scheme had never provided for RPI/5 increases and all the announcements H received were said to be subject to the terms of the rules. The rules actually provided for increases as directed by the employer. The Ombudsman concluded that based on the evidence, the employer had directed in accordance with the rules that H would be paid increases at RPI capped at 5%.

The actual award made by the Ombudsman was complicated but in broad terms, he directed that H's executive pension prior to 1 April 2025 should be increased as promised by RPI capped at 5%. However, from 1 April 2025, H's pension increases should reflect the rules of the transferring scheme and be at a rate determined by the trustee, at the employer's direction. The Ombudsman also directed the employer to amend the scheme rules or augment H's benefits to give effect to the promised mirror image benefits and pay H £1,000 for the serious distress and inconvenience sustained.

Relevance: This is a cautionary tale about the need to ensure that benefits payable following mergers and bulk transfers are properly documented. What may be clear to everyone at the point of transfer is easily lost in the mists of time.

As H was the only member in his category, he had communications directed solely at him and direct conversations about his benefits. It could be significantly more difficult for other members to demonstrate a similar level of commitment and clear intent to provide a particular level of benefits.

Practical points:

- *Be aware that promises made to members which are not reflected in scheme rules can be enforced.*
- *Consider whether any benefits promised on bulk transfer exercises may not have been fully documented.*

PENSIONS REGULATOR FOCUS

The Pensions Regulator has recently made a number of comments about what its regulatory focus will be for 2025 and the way it intends to act as a regulator. In particular, it is proposing that the supervision regime in relation to master trusts will evolve to reflect the levels of risk that different schemes pose to both members and the market.

TPR has announced that it is changing its approach to supervising master trusts, following a 12 month review, with the aim of identifying "*market and saver risks sooner and [to] enhance the pensions system*". Its focus will be on making sure members receive value for money, with clear priorities around investments, data quality and innovation at retirement.

TPR's (slightly) more detailed proposals are set out in a report on DC and master trust supervision. DC schemes will be grouped into one of four categories: monoline master trusts (larger schemes that carry a higher risk to the market); commercial master trusts; non-commercial master trusts and collective defined contribution schemes; and single and connected employer DC schemes

Each segment will have tiers of engagement based on the specific risks they present to the market and member outcomes. Every scheme in the first two segments will be allocated a dedicated multi-disciplinary team of named individuals with expertise in financial analysis, business strategy, investment and governance.

The new approach is part of TPR's move to a more prudential style of regulation, focusing on addressing risks not just at an individual scheme level, but also those which impact the market and wider financial ecosystem.

There is a lack of detail on what this new approach actually means but it is suggested that TPR will be able to be clearer with schemes about its expectations which will lead to more robust strategic decision-making. There should also be fewer and less frequent, but more targeted data requests to schemes, cutting regulatory burden.

A second press release sets out what the industry can expect from TPR in 2025. TPR confirms its more prudential approach and says that it will continue to engage with industry to determine what challenges it faces and how they can be overcome. In addition, over the next year TPR intends to:

- say more about the need for better data and how it will support scheme to raise standards;
- launch an innovation hub to encourage the industry to support market innovation and facilitate discussion;
- set out its future approach to enforcement and tackling serious crimes;
- make sure value for money is at the heart of its work, progressing the value for money framework with the FCA;
- continue focus on climate-related risks and opportunities from the UK's transition to a net-zero economy;
- implement a more strategic approach to raising standards of trusteeship; and
- help DB schemes consider the full range of alternative models of provision through new guidance.

A lot of these proposals are in vague regulatory language and the specifics are far from clear. However, more is definitely coming on value for money in a DC context (as we have already seen a detailed consultation from the FCA) and probably in relation to data and record keeping as that will form an important part of the effective operation of the pensions dashboards.

It will be interesting to see what the guidance on "alternative models" for DB schemes looks like and whether it does anything more than promote consolidation.

Practical points:

- *Watch out for more details on regulatory initiatives.*
- *Be aware of shift in approach for DC and master trust regulation where relevant.*

PLSA STEWARDSHIP AND VOTING GUIDELINES

The PLSA has updated its voting and stewardship guidelines for trustees which provide a framework for trustees and their advisers to pursue stewardship agendas and determine voting policies.

The Disclosure Regulations require trustees to prepare an annual report within 7 months of the end of each scheme year. One of the things it must contain is a description of "*the voting behaviour by, or on behalf of, trustees (including the most significant votes cast by trustees or on their behalf) during the year*" and whether the services of a proxy voter have been used. This information also needs to be included on a publicly available website, free of charge.

In addition, where trustees are required to prepare a statement of investment principles (**SIP**), it must set out their policy in relation to "*the exercise of the rights (including voting rights) attaching to the investments; and… undertaking engagement activities in respect of the investments (including the methods by which, and the circumstances under which, trustees would monitor and engage with relevant persons about relevant matters).*"

DWP issued guidance in 2018 on how schemes should report their stewardship activities, both in the SIP and online. The guidance says that "*DWP expects trustees to either set their own voting policy or if they have not set their own policy, acknowledge responsibility for the voting policies that asset managers implement on their behalf. Ultimately, trustees are encouraged to take ownership of the scheme's stewardship policies. This means it is not enough for trustees to simply report that they have delegated stewardship to their asset managers*". It accepts that there may be more constraints where trustees are invested in pooled funds but highlights ways in which trustees can still be actively engaged.

In relation to the voting information that should be placed on a website in the implementation statement, the guidance suggests that a slightly surprising amount of information is required. It says that as a minimum, trustees should include the following in relation to the most significant votes:

- Which stewardship priority the vote was linked to.
- The company's name (unless there are particular sensitivities around disclosing this) and date of the vote(s).
- Approximate size of the scheme's/ mandate's holding as at the date of the vote.
- A summary of the resolution.
- How the trustee, asset manager, or service provider voted.
- If the vote was against management, whether this was communicated ahead of the vote.
- Rationale for the voting decision.
- Outcome of the vote.
- Whether the trustee / asset manager / service provider intends to escalate stewardship efforts.

The PLSA issues stewardship and voting guidelines each year which can help to formulate stewardship policies and an approach to voting.

The 2025 guidelines have just been issued and they:

- Provide an overview of recent political and economic developments that have an impact on stewardship;
- Sustainable finance developments, including the new Government's focus on this area;
- Social factor developments, including the DWP Taskforce on Social Factors;
- Workforce developments, including issues such as maternity and paternity pay and leave policies, and ethnicity and disability pay reporting;

- Guidance as to what “good” looks like in a variety of corporate scenarios; and
- Guidelines on how to vote in different scenarios.

Practical points:

- *Ensure awareness of stewardship and voting requirements.*
- *Consider whether policies need to be reviewed and updated.*

WATCH LIST

For upcoming developments see our pensions: what's coming 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. The FCA has consulted on the requirements for personal pension schemes. 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 further updated interim superfund guidance - issued July 2024. Draft legislation on superfunds expected in Pension Schemes Bill.
3	Pensions tax	Changes are anticipated from 6 April 2027 in relation to inheritance tax (IHT) on lump sum death benefits and inherited benefits. Changes to be made from 6 April 2026 in relation to need for UK scheme administrators. Changes to be made to overseas transfer regime from 6 April 2025 to bring transfers to schemes in EU or EEA in line with transfers to schemes elsewhere in the world.	Draft legislation awaited in relation to IHT changes.
4	Repayment of surplus	The reduction in the tax charge took effect on 6 April 2024. Further changes to legislation in relation to refunding surpluses have no clear date.	Tax charge on repaying surplus reduced from 35% to 25%. The Government has announced that changes will be made to surplus legislation but has yet to publish details. Provisions may be included in the upcoming Pension Schemes 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 came into force on 12 November 2024.	Strategy statements will need to be submitted electronically, the format for which will be published in spring 2025.

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. No dates are known as to when any progress will be made.	TPR will consult on an 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.	All registrable UK-based schemes with active and/or deferred members.
8	Collective defined contribution schemes	Legislation allowing unconnected multi-employer schemes may be issued in 2025.	The Government has consulted on the possibility of extending the legislation allowed collective defined contribution schemes to schemes for unconnected-employers, paving the way for commercial providers to offer such schemes.
9	DC consolidation	Proposals on default funds may come into force in 2030.	The Government has consulted on requiring multi-employer DC schemes to have a maximum number of default funds of a minimum size.

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

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