SLAUGHTER AND MAY/

PENSIONS ESSENTIALS

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ANNUAL FUNDING STATEMENT

The Pensions Regulator has issued its first annual funding statement since the new funding and investment strategy provisions came into force in September 2024. The statement is focussed on TPR's expectations for schemes with valuation dates between 22/9/24 and 21/9/25 but is relevant to all DB schemes.

There are a number of points worth noting in TPR's annual funding statement:

- **Funding levels:** Funding levels are slightly lower than in the previous year but around 85% of schemes are still in surplus on a technical provisions basis and 54% on a buyout basis.

  Trustees should understand the risks the current climate poses to their investment strategy and covenant and ensure they have robust processes in place to enhance the scheme's resilience to market shocks (although some commentators have pointed out this may be difficult given current economic volatility).

  Where funding is at or above low dependency levels, if trustees decide to run on, they "*will need to weigh the benefits against the ongoing risks and put in place suitable monitoring and management strategies [and] continue monitoring the employer covenant to ensure it continues to provide the necessary support…*"

  Finally, it is worth noting that TPR expects that around 80% of schemes will be able to use its Fast Track funding approach, minimising the information that needs to be provided to it and TPR engagement. This may require a change to the funding approach but TPR says this is likely to result in minimal or no cost to the employer.

- **Risk:** When assessing the level of risk employer covenant can support, a proportionate approach should be taken. A lighter touch may be more appropriate where a scheme has lower reliance on covenant, e.g. where it is well funded and running limited levels of funding and investment risk, and not planning to increase this going forward.

  Where the reliability period has no bearing on the level of risk being run (e.g. where the scheme is fully funded on low dependency basis, with any surplus being sufficient to cover any risk within the journey plan), trustees should focus on identifying any material covenant risks that could lead to the scheme not paying benefits in full.

- **Covenant assessment:** When considering any covenant assessment, trustees should look at what aspects of the covenant they are placing the most reliance on, e.g. if risk is being taken on the basis of a contingent asset, greater focus should be placed on evidencing the value of that contingent asset.

  Low dependency is not no dependency. Covenant support will still be required until the scheme is transferred to another entity or wound-up. Even at low dependency, trustees should continue to monitor covenant. However, they can take a proportionate approach and focus on the key risks that could lead to a deterioration in covenant.

- **Surplus:** Until more detail around surplus extraction is provided by the Pension Schemes Bill, when considering options in respect of surplus, trustees should follow existing legislation and the provisions in scheme rules. It is good practice to have in place a policy for the release of surplus in the context of their individual scheme, and they may wish to start thinking about how they would approach any requests from the employer to release surplus.

- **Endgame strategy:** In relation to determining what long-term objective to include in a strategy statement, TPR says "*The statement of strategy allows flexibility when describing the long-term objective… This should allow trustees to accurately describe their specific plans. For example, aiming to reach buyout at an unspecified point after the relevant date… Trustees will need to decide if the commitment to achieve buyout is clear and settled enough for it to be appropriate to include in the funding and investment strategy*".
- **Guarantees:** TPR confirms that PPF standard guarantees do not meet the criteria for a look through guarantee. Where a scheme has a guarantee that is only triggered by an insolvency of the employer or missed deficit repair contributions, any assessment of maximum affordable contributions should be based on the cashflows of the statutory employers only. If trustees run risk based on such a guarantee, should the risk crystalise, it will lead to a longer recovery plan than if a look through to affordability was provided by the guarantor.

TPR has also just published its digital service to allow schemes to submit valuation information on-line. This includes a statement of strategy spreadsheet for completion.

Practical points:

- *If a valuation process is currently ongoing, consider TPR's comments.*
- *Use the new digital platform to submit funding documents to TPR.*

SMALL POTS

The consolidation of small DC pots has been under consideration for a number of years because of the potential cost to industry and the risk that members lose track of them. The Small Pots Delivery Group has published its latest report setting out recommendations to deal with this, which are accompanied by proposals from the Government.

Successive governments have observed that the proliferation of small pots under the auto-enrolment regime has resulted in members losing track of some benefits and a disproportionate administration cost. The Government estimates that small pots cause annual industry-wide losses of up to £225m and result in a reduction in value for members.

In 2023, a government response to consultation proposed that for the purposes of any future consolidation legislation, small pots would be those that:

- have been created since the introduction of auto-enrolment;
- are within auto-enrolment charge-capped default funds;
- have had no active contributions made for a period of at least 12 months; and
- are valued at £1,000 or less (although the pensions minister's foreword to the recent report refers to this as a starting point, suggesting that the regime may be extended to apply to larger pots in the future).

The response to consultation also proposed that schemes would be required to transfer eligible small pots to one of multiple default commercial consolidators, with an opportunity for the member to choose their desired consolidator scheme. A central clearing house would be responsible for matching deferred pots and lead on communication with members and there would be an authorisation and supervisory regime for schemes acting as consolidators.

Legislation is expected in the Pension Schemes Bill (anticipated to be published in the next few months) to take these proposals forward. The report and the Government's response to it provides more information about what it is likely to include - although detail is more likely to be in future regulations than the Bill:

- **Infrastructure:** There will be a small pots data platform (**SPDP**) which could be funded by the General Levy. Where schemes identify a pot to be consolidated, they will approach the SPDP who will be responsible for verification, matching members to existing pots with consolidators and facilitating the consolidation process. A decision has yet to be made on whether the SPDP should hold and maintain records as this will be considered as part of a Feasibility Review which should conclude in June 2025. The PLSA will lead a review into the design and implementation of the SPDP.

- **Communications:** In a departure from the original proposals, the SPDP will not be responsible for member communications – these will be the responsibility of the original and consolidator scheme. As part of the authorisation process, schemes will need to show evidence of high-quality communication and engagement with their current membership. It is proposed that there should be two standardised points of communication with members. The first when the pot has been identified as eligible for consolidation, and the second once the pot has been consolidated. These communications will need to come from the transferring scheme.
- **Allocating members to a consolidator:** Where members have chosen a consolidator, they will be transferred into that. If they have not made a choice, they will, where possible be transferred into a scheme where they already have a pot. If they have multiple pots with different consolidators, they will be allocated to the scheme which holds their largest pot. If they don't have a pot with a consolidator, they will be allocated to one.
- **Authorisation:** It is envisaged that the consolidators will be existing master trusts. The delivery group recommended that they must meet the requirements for auto-enrolment and offer a sharia compliant fund, as well as having a specified level of scale to provide economies and tolerate loss making pots or a clear business plan showing that they will reach that scale within 3 years. They will also need to demonstrate that they are providing good levels of value for members and provide protection from flat fees. The legislation will allow for the possibility of GPPs as consolidators but there appears to be limited appetite for this at the moment.
- **Transfers:** The delivery group recommends that a 12-month time limit would be sufficient to transfer out small pots. It is not clear when this period would run from or whether there will be a longer initial transitional period to transfer out accumulated small pots.
- **Liability:** A liability framework will be needed to ensure that members are protected if errors are made and that they can be put back into the position they would have been had everything been done correctly during the consolidation process. The liability of ceding and receiving schemes is dealt with under the existing law. If the SPDP is responsible for an error, an alternative funding mechanism will need to be established. It is also proposed that the General Levy will be the funder of last resort where a scheme that is found to be at fault for an error no longer exists in the market.

The intention is that regulations will be drafted during 2026 with elements of the legislation expected to come into force during 2027/2028. Duties on pension schemes to transfer and consolidate eligible pots are likely to come into force from 2030 with a phased approach to implementation.

For more insight on these proposals, see the recent blog by Patricia Critchley in our pensions team.

Practical points:

- *Watch out for draft legislation.*
- *Consider how easy it would be to identify small pots.*

MANSION HOUSE ACCORD

Some of the largest work place pension providers have voluntarily agreed to try to invest at least 10% of assets in their main DC default funds in private markets by 2030 with at least 5% of the total allocated to UK private markets.

The Mansion House Accord was entered into earlier this month by seventeen workplace pension providers, managing around 90% percent of active savers' DC pensions.

The signatories have agreed to invest 10% of their main default funds in private markets or what the Government describes as "*assets that boost the economy such as infrastructure, property and private equity*" by 2030. At least 5% of this amount will be ringfenced for investment in the UK.

This pledge is subject to a number of things, including:

- Existing fiduciary duties and the consumer duty on FCA regulated entities to prioritise the needs of customers.
- A pipeline of UK investment opportunities, which the Government has agreed to facilitate.
- A market shift from cost to value and successful delivery of the upcoming Value for Money framework.
- Alignment of the FCA and Government on a number of issues.
- Delivery of policy change on bulk transfers without consent in contract-based schemes, allowing them where it is in the best interests of savers and subject to necessary safeguards.
- A pragmatic approach "*to the scale tests proposed by Government in a way that ensures competition and innovation in the market and that does not prevent signatories from investing in private markets at scale, in the near term*". This refers to proposals that default funds in commercial schemes should be a minimum size and the final report of the Investment Review contains more details about these proposals and will be covered in more detail in a separate briefing.

The Government press release welcomed the Accord, saying that up to "*£50 billion of investment for UK businesses and major infrastructure projects is set to be unlocked through a new agreement with Britain's biggest pension funds*". It does not however mention the preconditions which are set out in the Accord or its role in satisfying them.

The Government says that "*progress against the commitment will be monitored and the initiative will be reinforced by measures to be announced in the upcoming final report of the Pensions Investment Review.*" The final report of the Investment Review says that the Pension Schemes Bill "*will include a reserve power which would, if necessary, enable the Government to set quantative baseline targets for pension schemes to invest in a broader range of private assets, including in the UK*", although it says that this power will only be used if industry does not deliver change on its own. More details about these proposals will also be included in an upcoming briefing.

The Accord should not be confused with the 2023 Mansion House Compact, where eleven funds committed to the aim of investing 5% of their workplace DC default funds in unlisted companies by 2030. The new commitment involves a greater number of providers, brings more assets into scope, doubles the target from 5% to 10% and includes a specific commitment to investing 5% in the UK. Whether it will yield the advantages to the UK economy that the Government envisages remains to be seen.

Practical points:

- *Watch out for further developments on default funds as a result of the Investment Review.*
- *Watch out for possible legislation in relation to occupational pension scheme investment.*

SUPERFUND TRANSFERS – LESSONS SO FAR

The Pensions Regulator clearly believes that consolidation of both DB and DC schemes is in the interests of members and has issued a blog reflecting on the three transfers so far to the only DB superfund (Clara) with the intention of facilitating such transactions in the future by clarifying its expectations.

TPR estimates that at the end of 2024, approximately 40% of DB schemes could potentially have met the primary tests to consider whether a superfund transfer was in members' interests and of those, around 1,400 had less than £100 million assets. It says that: "*Smaller schemes are more likely to particularly benefit from improved governance and access to investment and risk management opportunities that may otherwise be out of reach, as well as economies of scale in running costs*". However, TPR is aware that the superfund market needs scale to take on small schemes and hopes the upcoming Pensions Schemes Bill will provide appropriate incentives for the market to expand.

In the meantime, it has issued a blog setting out its top tips for schemes considering transfers to a superfund. Based on its experience to date (which consists of 3 transfers to Clara of over 20,000 members and assets of around £1.5 billion), it has identified some friction points in superfund transfers:

- **Gateway tests:** There are 3 gateway tests a scheme must satisfy before TPR will clear a transfer to a superfund.

The first is that the scheme cannot access buy-out now. TPR says that the scheme does not need to obtain a buy-out quote from an insurer to demonstrate this, an objective estimate of the cost of executing a buyout from an actuary with experience of the market will suffice.

The second test is that the scheme has no realistic prospect of buy-out in the foreseeable future, given potential employer contributions and insolvency risk. TPR says that a strong rationale for the transfer is vital where the scheme has ongoing employer support, but clearance is possible in these circumstances.

The third test is that a transfer to the chosen superfund will improve the likelihood of members receiving full benefits. TPR recognises that this is a matter of judgement, particularly where a key factor is the ability of the employer to support the scheme outside the superfund. It does not necessarily expect mathematical quantification of likelihoods.

- **Due diligence**: Trustees need to demonstrate that they have done appropriate due diligence in relation to a superfund transfer. However, TPR says that it will have scrutinised the legal and governance structure, systems and processes and key people of all superfunds listed on its website and would not be concerned if trustees carried out minimal due diligence on these aspects.

  Schemes will need to provide a comprehensive rationale for transferring, including supporting advice and evidence. This should set out why transferring is in members' interests and the pros and cons of doing so. TPR urges schemes to be transparent and says that rarely will there be no cons.

- **Bulk transfer terms**: The terms of a transfer, including cash injections from the employer and superfund, are often struck based on the financial position of the scheme months before the date of transfer. As such, certain "boundary conditions" are agreed which will trigger a reassessment. TPR says that assessing boundary conditions right up to the date of transfer is impracticable and there comes a time when all parties must commit. It would be unlikely to be concerned if boundary conditions terminate on the date members are notified of the pending transfer.

TPR also says that new guidance on DB Endgame Options, which it is planning to publish soon, will explore the wider range of options available in 2025 for DB schemes.

Practical points:

- *Watch out for Endgame Options guidance from TPR.*
- *Take TPR's comments into account if considering a superfund transfer.*

DASHBOARDS AND AVC PROVIDERS

PASA has issued an AVC/split administration toolkit to help where a scheme has more than one administrator (e.g. for AVCs) and they are connecting to the dashboards separately. It sets out TPR's intention to take a pragmatic approach where connection by the provider on the on the same date as the main scheme is not possible.

Where a scheme has a separate AVC provider, such a provider may be happy to provide dashboard information to the scheme and for the scheme to provide that information to the dashboard. Alternatively, some AVC providers intend to connect directly to the dashboard ecosystem and provide information themselves to the dashboards.

Under the dashboard legislation, the responsibility for complying with dashboard requirements, including ensuring that required member information is provided within prescribed (and fairly tight) timescales, is the trustees' – not that of the AVC providers. This means that trustees need to work closely with AVC providers to understand the approach that they are taking and ensure that all dashboard requirements are satisfied.

To assist trustees with this, PASA have issued an AVC toolkit. The toolkit focuses on connecting to the dashboards and ensuring that AVC providers meet the main scheme connection deadline as dashboard compliance obligations apply to <u>all</u> benefits from the date a scheme first connects to the ecosystem.

PASA has liaised with the FCA and TPR who have said:

- They expect all parts of the scheme to connect at the same time. This includes schemes that have multiple sections or members with AVCs.
- Where a scheme is unable to connect all sections at the same time, it is expected that efforts are made to connect any remaining sections at the earliest opportunity.
- They will take a pragmatic approach to any failure, taking into account the potential impact on members.
- Occupational schemes should follow TPR's breach of law guidance to consider whether they need to report such a breach to them with relevant remedial activities. TPR will not normally consider this breach to be materially significant if prompt and effective action is taken to connect the rest of the sections by the longstop connection deadline of 31 October 2026. This guidance has dashboard specific examples to assist trustees in deciding whether to report a breach to TPR.

Similar issues may arise where an integrated service provider associated with the scheme is not connected to the ecosystem by the staging date set out in DWP's guidance. In this scenario, the toolkit echoes the approach set out above and says: "*TPR have confirmed that at this current time, there will be no regulatory intervention for pension providers and schemes who are unable to meet their connect by dates in guidance solely due to their dependence on a volunteer participant who has yet to connect*".

Where a scheme has multiple administrators, the guidance sets out practical steps for trustees and suggests that where it is not possible to avoid connection on a phased basis, this should be noted in the breaches log and assessed in line with TPR's reporting breach guidance above.

Practical points:

- *Identify whether the scheme has a separate AVC provider.*
- *Work with them in relation to dashboard connection.*

GOVERNMENT INITIATIVES INCLUDING SURPLUSES

The Government has been drip-feeding information on a number of pensions initiatives lately including surplus refunds, PPF compensation, the transfer conditions and trusteeship. There is also a suggestion that changes in relation to the notifiable events regime set out in the Pension Schemes Act 2021 may not be progressed.

Surplus: In a recent press release, the Government confirmed that the upcoming Pension Schemes Bill (expected before summer) will contain provisions to facilitate the release of surplus in ongoing schemes. It says that the changes will "*allow Pension trustees and the sponsoring employers to safely release some surplus to invest back into their businesses and unlock more money for pension scheme members… [and] will focus on member protection, and trustees will continue to be required to fulfil their duties towards scheme beneficiaries*".

Just as this edition of Pensions Essentials was going to press, the Government issued its response to consultation on Options for DB Schemes. This sets out its proposals in relation to release of surpluses which include a statutory power for trustees to modify scheme rules to provide for surplus sharing and possible amendments to the threshold at which surplus can be refunded to an employer from buyout to full funding on the low dependency funding basis. The response says that the Government does not intend to mandate how extracted surplus must be used. More detail about these proposals will be set out in an upcoming briefing.

PPF: The response to consultation on Options for DB schemes says that the Government is continuing to consider the possibility of using the PPF as a public consolidator and what that would look like.

In addition, the Government says it has heard requests to review the level of compensation paid by the PPF, specifically in relation to the award of pre 1997 indexation but that: "*Any change in this area has significant implications on public finances… Assets and liabilities for the PPF are reflected within the Government accounts, and any use of the PPF reserve and increases in future liabilities have an impact on the public finances… we will need to work through the issues to* *ensure a balance can be struck between all parties, including the interests of members of failed schemes, the levy payers who support the PPF and taxpayers*". So, it remains far from clear what, if any, developments there will be in this area.

Transfers: The pensions minister has confirmed in response to a written parliamentary question, that DWP is working with regulatory bodies and the industry to consider how the transfer process can be improved for members.

This follows industry concerns that the transfer conditions introduced in 2021 to combat scams, including a requirement for some members to seek guidance from Money Helper, is unnecessarily delaying transfers. However, as it has been clear since the conditions were launched that some of them were problematic it seems unlikely that changes in this area are considered a priority issue.

Trusteeship: In relation to the growth in sole trusteeships, the Government's response to recommendations from the Work and Pensions Committee says that in its view, there are already significant safeguards in place in the form of TPR's powers to remove and replace trustees or add an independent trustee where there are concerns about existing trustees' capability or behaviour. It also notes that TPR has said it is extending its oversight of professional trustees.

However, Government has said it will consult on trusteeship later this year and the consultation will cover a framework for accreditation and governance of trustees and consider what further action might be needed to protect members as the trustee landscape continues to change. It will also consider how TPR and DWP can support lay trustees (including member-nominated trustees) where they need it.

There is also confirmation that TPR continues to work on its trustee register and a suggestion that TPR might in some way be able to monitor usage of the Trustee Toolkit to develop a "*clearer view of areas… where support and intervention may be required*."

Notifiable events: The Pension Schemes Act 2021 contains provisions which, if enacted, would require employers and entities connected or associated with them to give notice to TPR of a decision in principle to sell a material proportion of the employer's assets or to grant or extend security over its assets. DWP consulted on regulations in 2021 which set out more detail about how these new notifiable events would operate. However, neither the provisions of the Act or the draft regulations have ever been brought into force and there has been no update from the Government for some time in relation to them.

The FCA published a regulatory initiatives grid which is intended to set out the regulatory pipeline so that industry can understand the timing of initiatives that may have a significant operational impact. TPR's work on updates to its notifiable events code of practice to reflect the changes in the Pensions Schemes Act is listed in the grid under "initiatives that have been completed or stopped", suggesting that no more work is being done on it at the moment.

Whilst this is not conclusive evidence that the notifiable events changes will not be brought into force, it is the clearest indication we have had of that so far.

Practical points:

- *Watch out for daft legislation on surplus refunds.*
- *Watch out for further consultation in relation to trusteeship.*

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	2025/26 Pension Schemes Bill to be laid before Parliamentary summer recess (currently 22 July 2025).	Anticipated that wording for new value for money framework in occupational pension schemes will be included in the 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	2025/26 Pension Schemes Bill to be laid before Parliamentary summer recess (currently 22 July 2025). Public consolidator to be established by 2026, consultation on features closed on 19 April 2024, a response to which is expected in spring 2025.	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.	Draft legislation awaited in relation to IHT changes.
4	Repayment of surplus	Further changes to legislation in relation to refunding surpluses is due to be included in the Pension Schemes Bill to be laid before Parliamentary summer recess (currently 22 July 2025).	The Government has just published more details on its proposals it its response to consultation on Options for DB Schemes (29 May 2025).
5	Funding and investment strategy requirements for DB schemes	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 has just been published by TPR.
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.	It appears that TPR has ceased work on the notifiable events code of practice so it is not clear whether there will be any further developments in relation to this.

No	Topic	Effective date or expected effective date	Further information/action
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	The Government has said that legislation allowing unconnected multi-employer schemes will be issued in Autumn 2025.	The Government has consulted on the possibility of extending the legislation allowed CDC 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. Further details of these proposals are set out in the final report of the Investment Review (29 May 2025).

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