BRIEFING

What's Happening in Pensions

Issue 99 – December 2022

In this issue:

DB scheme funding: The Pensions Regulator has published consultations on its draft funding code of practice and a fast-track filtering mechanism. These relate to the forthcoming requirement for DB pension schemes to have a funding and investment strategy reflecting a long-term objective for providing scheme benefits.

Pension protection levy: The PPF has confirmed its 2023/2024 pension protection levy rules. There are no changes to the contingent asset rules but levies for the great majority of schemes will be smaller, in many cases significantly so.

Pensions dashboards: The Pensions Dashboards Regulations 2022, covering matters including schemes' connection deadlines, have come into force. The Government has finalised guidance for trustees on applying to defer their connection deadline. The Pensions Regulator is consulting on a draft compliance and enforcement policy. The Pensions Dashboards Programme has published revised standards for schemes connecting to the dashboards ecosystem and is consulting on design standards. The FCA is consulting on standards for dashboard operators.

Autumn statement and 'Edinburgh reforms': There was nothing directly on workplace pensions in the Autumn Statement but the Chancellor's announcements included some items of interest, including the outcome of the consultation on Solvency II reforms. Some pensions announcements were made in the Chancellor's 'Edinburgh reforms' statement but there was little that was new.

Liability-driven investment: The Pensions Regulator has issued a guidance statement calling on DB scheme trustees who use LDI services to maintain an appropriate level of resilience in leveraged arrangements to better withstand a fast and significant rise in bond yields. The FCA has endorsed the statement and added its own comments. The Financial Policy Committee of the Bank of England has recommended that further steps be taken by the Pensions Regulator. There is also a short Select Committee inquiry.

DB/hybrid scheme returns: The Pensions Regulator has updated its web page for DB and hybrid scheme returns, including example scheme returns and details of the changes this year.

DC member outcomes: The Pensions Regulator has published a blog post calling on DC scheme trustees to increase their investment skills and help members to access better investment opportunities, whether in their existing scheme or by consolidation.

Retained EU Law (Revocation and Reform) Bill: A Government minister has indicated that the Government intends to remove from UK law the requirements of the *Hampshire* and *Bauer* European Court judgments concerning the level of pension protection required following an employer insolvency. This would apply in respect of future insolvencies only.

PENSIONS RADAR: You may also be interested in the latest edition of Pensions Radar, our quarterly listing of expected future changes in the UK law affecting work-based pension schemes.

SUSTAINABILITY MATERIALS: Our Sustainable Business Hub includes a section on ESG and sustainable finance issues for pension schemes and their sponsors. We also recently published our latest ESG Newsletter.

DB scheme funding

The Pensions Regulator has published consultations on its draft funding code of practice and on its proposed regulatory approach, which includes a 'fast-track' filtering mechanism. This follows an earlier Regulator consultation on framework principles for the code (see WHiP Issue 81). The 14 week consultation period ends on 24 March 2023.

Background

Under the Pension Schemes Act 2021, DB pension schemes will need to have a "funding and investment strategy". This is a strategy for ensuring that benefits can be provided over the long term, whether by buy-out, consolidation or run-off. The strategy will need to include a targeted funding level(s) to be achieved by a particular date(s) and information on the investments intended to be held as at particular dates.

After determining or revising such a strategy, trustees will have to prepare a "statement of strategy": this must describe the funding and investment strategy (in terms agreed by the employer). It will also (in consultation with the employer) have to include information on:

- the extent to which the strategy has been successfully implemented;
- steps to be taken to remedy any deficiencies;
- the main risks in implementing the strategy and how they will be mitigated or managed; and
- reflections on any relevant significant decisions.

Scheme funding 'technical provisions' (liabilities assessed by reference to actuarial assumptions etc.) will have to be calculated in a manner consistent with the strategy. Trustees will have to send copies of all valuations to the Regulator with a copy of their statement of strategy.

The Regulator's new consultation follows on from the Government's recent consultation on draft scheme funding regulations but comes before the outcome of the Government's consultation. The Regulator is consulting based on the draft regulations but with some anticipation of possible changes to them. Any consequential changes to the code are to be discussed with industry but will not be consulted on publicly.

The draft regulations proposed that schemes must be funded with targets of 100% funding and low dependency on the sponsoring employer and a low dependency asset allocation by the time they reach the point of 'significant maturity', as defined.

For more detail of the statutory provisions and the consultation on draft regulations, see WHiP Issue 97.

The aim is still for the regulations and new code to apply to valuations that have effective dates on or after 1 October 2023. That means that the code will have to be laid in Parliament by June 2023.

Consultation – code of practice

The draft new code of practice is a very substantial document. It outlines the legislation and addresses various topics, the following of which are of particular interest:

- Broadly matched investments: The legislation's low dependency investment target requires cash flow from investments to be "broadly matched" with the payment of scheme benefits and expenses from the point the scheme reaches significant maturity. The draft code sets out the nature of assets that the Regulator considers acceptable for this purpose and its interpretation of the word "broadly": this can involve a relatively small proportion of growth assets, which can be higher with hedging (for example under a liability-driven investment arrangement). The Regulator considers that up to 15% of scheme assets can be allocated to growth assets and the scheme could still be "broadly matched". Schemes are not required to invest in this way before they reach significant maturity and they may be able to invest to a greater degree in growth assets, for example with the assistance of a strong employer covenant or suitable contingent assets.

  After significant maturity, the Regulator says that schemes will not be expected to be invested 100% in gilts. It says that corporate bonds, interest rate and inflation derivatives, and some property- and infrastructure-related investments are also appropriate. Up to 20% to 30% allocations to growth assets could still be appropriate (with hedging of risks where a scheme is at the top end of that range, for example by using leveraged liability-driven investment).

- Resilience: The assumed investment strategy must be such that the value of assets relative to liabilities is highly resilient to short-term adverse changes in market conditions. Trustees will be expected to carry out "a suitable level of analysis" to enable them to assess this: "As a minimum, we expect schemes to test for a one-year, 1-in-6 stress scenario when testing for resilience and, assuming they are fully funded on a low dependency funding basis, for the results of this test to be limited to a change in funding level of 4.5%.".
- Low dependency funding basis: The Regulator does not intend to be prescriptive as regards actuarial assumptions for the low dependency funding basis but the draft code sets out principles to be followed by trustees when determining their assumptions. A reserve for future expenses should be included unless the scheme rules require employers to pay them.
- Significant maturity: The point of significant maturity is when "the weighted mean time [in years] until the payment of pensions and other benefits under the scheme, weighted by the discounted payments" reaches a duration of liabilities figure set by the Regulator. The Regulator now proposes a figure of 12 years. Based on earlier Regulator comments, this is broadly equivalent to the point at which the scheme will be paying out 6% of its liabilities each year as benefits.

  The Regulator notes here that the regulations could well yet change. It has been observed that, on the basis of the definition in the draft regulations and in particular the sensitivity to gilt yields, many schemes in recent months unexpectedly reached significant maturity or moved much closer to it. Changes might seek to dampen this volatility, for example by adopting a smoothing mechanism for gilt yields or a fixed rate, or by setting the duration of liabilities figure as 10 years. The Regulator will react to whatever the Government decides in this regard.
- Employer covenant: As noted above, covenant is a key factor for trustees in assessing an appropriate 'journey plan' for the scheme as it moves towards significant maturity. The Regulator expects trustees of all DB schemes to assess covenant by reference to three distinct time periods, based on covenant visibility, reliability and longevity. The draft code includes a substantial section on this topic, with a consultation on updated guidance expected "in the coming months". When considering their journey plan, trustees must consider separately the period over which covenant can reasonably be relied upon and the period thereafter, with stochastic or deterministic analysis to help them understand plausible outcomes from risk events.
- Recovery plans: The code includes no benchmarks for recovery plan length (but see the fast-track section below). Schemes will be permitted to allow for investment outperformance where covenant supports that approach (but not under fast-track).

  The draft regulations included a contentious proposal that deficits must be recovered as soon as the employer can reasonably afford. The Regulator seeks to give that a relatively generous interpretation and suggests some "reasonable alternative uses" of available employer cash, including investment in sustainable growth. It briefly analyses the potential reasonableness of other uses of employer cash, such as shareholder distributions and discretionary payments to other creditors, taking into account factors such as scheme funding level and maturity.
- Liability-driven investment (LDI): The liquidity section of the draft code includes some discussion of LDI risks and the Regulator's expectations around managing the operational and governance considerations. The draft code includes the following: "In ensuring sufficient liquidity trustees should consider the impact of changes in key variables such as real and nominal interest rates, currency and credit spreads. For example, this could be that the trustees will hold enough liquid assets so that liability hedging can be maintained following a rise in long-term interest rates (real and nominal) of 300-400 basis points (bps). TPR may issue guidance on relevant benchmarks as appropriate.".

Consultation: regulatory approach and 'fast-track'

A significant change from the Regulator's original consultation is that 'fast-track' will now be a filtering mechanism for regulatory intervention rather than a benchmark against which funding and investment strategies will be assessed. It will not be part of the code of practice: it is set out in a separate document and can be changed more easily than the code.

Under the filtering mechanism approach, schemes that adopt the fast-track and are confirmed by the actuary as meeting its criteria are unlikely to be subject to regulatory action. Where a scheme misses individual parameters, the Regulator's engagement is likely to be limited to those areas.

Fast-track therefore represents not a minimum expectation but rather a tolerated level of risk, "a justifiable, prudent position that most stakeholders would recognise as within the range of reasonable outcomes that balances … competing priorities". As an equally acceptable alternative, schemes may submit a funding and investment strategy on a 'bespoke' basis. They may wish to do this if they consider that the fast-track parameters are too restrictive and where, for example, they can point to employer covenant strength and/or contingent asset cover (such as a guarantee) to support increased investment risk. The Regulator says that "Some trustees may find Fast Track a useful tool when negotiating with their sponsoring employers".

The Regulator expects just over half of schemes to be able to use fast-track. This was assessed in March 2021: the number may very well now be higher.

Points of interest include the following:

- Fast-track assessment factors: There will be three steps to consider:
  - Are technical provisions strong enough in relation to the calculation of low dependency liabilities? They should be expected to achieve 100% funding at the point of significant maturity.
  - Investment stress test – the PPF's test will be used to assess resilience. This would potentially allow 60% investment in growth assets for a scheme 15 to 20 years away from significant maturity.
  - Recovery periods must be no more than six years; or no more than three years after the scheme has reached significant maturity.
- Assumptions: The discount rate assumption for fast-track assessment will be set at gilts + 0.5% at significant maturity. The Regulator will also specify price inflation assumptions, consistent with the discount rate. Most other assumptions will be left to schemes to determine (subject of course to the fast-track actuarial confirmation). The duration of liabilities figure will be 12 years for fast-track, even if it is lowered to 10 in the code (see above).
- Covenant: The Regulator has now decided not to include covenant grading in the fast-track assessment.
- Open schemes: Schemes still open to accrual can use either fast-track or bespoke. Under either approach, they can make allowance for future accrual and new members joining, with the effect that they are further away from significant maturity. This should make it easier for them to use fast-track than would otherwise be the case.

Pension protection levy

The Pension Protection Fund (PPF) has published its 2023/2024 pension protection levy rules and policy statement, including all of the materials on contingent assets. There was also a short press release.

In consultation, the PPF had indicated that it considered it could reduce the total amount of levy it charges without risking the long-term security of members' benefits. It therefore proposed collecting £200 million in levy, a near halving of the amount it has aimed to collect this year (£390 million). This is now confirmed and there are no changes from the consultation proposals (see WHiP Issue 98).

There are therefore no changes to the rules on contingent assets, including guarantees. Schemes and guarantors will, however, wish to review their contingent asset cover in light of their very probably reduced levy and the coming scheme funding requirements (see above). Contingent assets need to be certified or recertified by 31 March 2023. Deficit reduction contributions need to be certified by 5pm on 28 April 2023. Invoicing starts in autumn 2023.

The levy reduction is to be achieved by reducing the sensitivity of levies to insolvency risk (i.e. so that it is not such a large factor) as well as changes the levy scaling factor and scheme-based levy multiplier that benefit all levy-paying schemes. Approximately 98% of schemes will therefore see their levy reduced and the majority of schemes paying a risk-based levy will see it fall by more than half.

Other points of interest include the following:

- Asset and liability stress factors have been updated to reflect the asset class categorisation that is being introduced by the Pensions Regulator into scheme returns for 2023 (see below). The stress test for equities is to be relaxed and applied the in same way across all quoted equities.
- The 2022/23 adjustment for schemes where employer insolvency risk increased due to the impact of the COVID-19 pandemic will not apply for 2023/24. Slightly under 10% of schemes took advantage of this. The easement offering affected schemes more time to pay is, however, continued.
- Scorecard 6 ('Group Small') was not performing as expected and has been revised.

- The Dun & Bradstreet insolvency risk portal has been improved.

Pensions dashboards

Regulations and deferral of connection

The Pensions Dashboards Regulations 2022 came into force on 12 December 2022. They add detail to the framework provisions in the Pension Schemes Act 2021, including the staging timetable for schemes to connect to the dashboards ecosystem.

The coming into force of the regulations commences the 12 month window period in which schemes may apply to defer their connection deadline. Under the legislation, deferral is only possible in very limited circumstances involving a change of administrator or a contractually required retendering. The Government has now finalised its guidance for trustees on applying for deferral. The last possible date for applications is 11 December 2023 but some schemes will have an earlier cut-off than this because the regulations require applications to be made not less than two months before a scheme's connection deadline.

For details of the requirements on pension schemes as regards pensions dashboards, see our website article '10 actions for getting to grips with pensions dashboards'. We are currently updating it to reflect the latest developments.

Enforcement

The Pensions Regulator is consulting on a draft compliance and enforcement policy concerning schemes' obligations in relation to pensions dashboards.

The draft policy says: *"We recognise that delivering pensions dashboards is a huge challenge for industry. We will be clear in our expectations and provide tools and education to help people meet their duties. We will take a pragmatic approach to compliance and will work with schemes to reach the best outcome for the saver. However, where we see wilful or reckless non-compliance, we will take a robust enforcement approach."*.

It also highlights the Regulator's enforcement powers against third parties, such as employers, administrators and integrated service providers.

The Regulator also reminds readers that existing duties to report breaches of the law apply.

A "What we expect" section reads as follows:

> *"We expect that governing bodies will have read, considered and implemented our guidance where appropriate, as well as standards and guidance issued by MaPS. They may also wish to consider industry guidance regarding good practice.*
>
> *We expect schemes to operate adequate internal controls in line with our new code of practice. This includes but is not limited to:*
>
> - *reviewing and assessing the quality of their data from multiple dimensions, and putting adequate controls around them for continuous improvement*
> - *having appropriate controls when selecting, appointing and managing service providers*
> - *having risk management processes in place, including processes for monitoring the resolution of issues between the scheme and any relevant third parties*
> - *having processes in place to identify breaches of the law and, if necessary, report them to us*
>
> *We expect schemes to keep clear audit trails of how they took steps to prepare to comply with these duties, to keep a record of compliance as set out in MaPS' reporting standards and keep a record of steps taken to resolve any issues that arose, such as communications with third parties. We expect them to keep records of their matching policy, and the steps taken to improve their data. These records would help provide us with a rounded and transparent view of their efforts to comply with legislation.*
>
> *We expect third parties to help and support schemes in meeting their duties appropriately. This includes employers providing schemes with the required information to enable them to perform their duties."*

A single problem affecting all or many relevant members of a scheme can lead to multiple breaches of the legislation. In such cases, the Regulator says: *"we will also consider the total amount of penalty issued in light of the circumstances of the breaches and the impact they have had"*.

An appendix considers various scenarios where something has gone wrong, with unsurprising indications of what a proportionate, risk-based regulator would expect to do in those circumstances.

The consultation closes on 24 February 2023.

Revised standards

The Pensions Dashboards Programme (PDP) has published revised standards for schemes connecting to the dashboards ecosystem. They will come into force following ministerial approval. This follows a consultation (see WHiP Issue 97).

The standards are as follows:

- Data standards: These set out the data formatting requirements that schemes and pension providers must follow when returning pensions data.
- Reporting standards: These set out the requirements on schemes, pension providers and dashboard providers for generating, recording, and reporting data to the various authorities.
- Technical standards: These are what data and dashboard providers will use to interface with the central digital architecture and/or each other.
- Code of connection: This sets out how pensions providers and schemes, and dashboards providers are to connect to the dashboards ecosystem and what they need to do to remain connected. It details the mandatory requirements that must be met, as well as the recommended ways in which participants should implement them.

Changes to the consultation drafts are noted on the web pages linked to above.

Design standards consultation

The PDP is consulting on the mandatory design standards which will set out how qualifying pensions dashboards will present information to users.

Generally, it will require the information to be presented clearly in a comprehensible, neutral and logical manner that is engaging, accessible (by reference to accessibility standards) and inclusive (bearing in mind Equality Act 2010 protected characteristics and vulnerabilities). The standards will set out a framework for how a qualifying dashboard must structure the display of pensions information and the requirements relating to this display. A principles-based approach is proposed but with some specific directions for the purposes of consumer protection.

There are two sequential stages for presenting pension information. This follows the initial display of generally relevant information about how the dashboard system works and about MaPS. The two stages are first a summary and then more detailed information:

- The summary shows key information for all the pensions found, including annual pension figures, and lists any possible matches. The state pension entitlement must be displayed first. The summary will include links to the detailed information.
- The detailed information stage displays all the information returned by each scheme, presented in a neutral and logical manner, though this can be customisable by the user. Graphic representations are permitted (for example a time and money graph).

Qualifying pensions dashboards will have some flexibility to tailor their offering and include graphic illustrations. They must include "labels" alongside information: these are, for example, buttons or drop-down boxes which users can use to see explanations of the information presented – e.g. explaining that a DB pension figure is not necessarily yet accessible or that a DC pension illustration assumes no tax free lump sum, indexation or contingent survivor's pension.

The MaPS initial dashboard is not a "qualifying pensions dashboard service" under the legislation and so is not bound by the design standards. The PDP says that the MaPS dashboard will comply "as far as it can".

This consultation, which closes on 16 February 2023, follows a call for input in summer 2022 (see WHiP Issue 97). The PDP expects to issue the design standards "in or around, summer 2023".

FCA rules for dashboards providers

The FCA has published a consultation on standards for operators of qualifying pension dashboards. This sets out the FCA's proposed approach to supervision and enforcement, including on fees, regulatory reporting, record keeping, prudential requirements and conduct rules.

Dashboard operators will be able to offer savers additional services that improve engagement with pensions provided they meet rigorous conduct standards. These services could include investment advice (including robo-advice) or guidance, as well as the provision of models, calculators and similar tools.

The consultation runs alongside the PDP's design standards consultation, also closing on 16 February 2023. The outcome is expected at the same time (summer 2023).

Autumn statement and 'Edinburgh reforms'

Autumn statement

Despite the usual speculation, there was nothing directly on workplace pensions in the Chancellor of the Exchequer's Autumn statement.

Points of interest to the pensions industry include:

- The Solvency II reform consultation outcome has been published. The Government will legislate in respect of UK insurers to:
  - *"ensure the risk margin is changed to reduce the risk margin for long-term life insurance business, including Periodic Payment Orders, by 65%, and for general insurance business by 30%, under recent economic conditions and to enable a modified cost of capital approach to its calculation;*
  - *maintain the existing methodology and calibration of the fundamental spread, while allowing for the use of notched ratings; and*
  - *broaden the matching adjustment eligibility criteria to include assets with highly predictable cashflows, subject to adjustments to the fundamental spread allowance and safeguards to be implemented by the PRA".*

  The response notes that the risk margin reductions are expected to lead to better prices for insurers' customers. Regarding concerns about policyholder protections, it says:

  > *"Policyholders will remain protected by the Solvency Capital Requirement, requiring insurers to hold enough capital to withstand a 1-in-200-year shock, and the PRA's existing supervisory powers, coupled with the additional measures that the PRA will take forward as set out in Chapter 1. The Financial Services Compensation Scheme will remain in place as a further safeguard for policyholders."*.

  That change and the matching adjustment eligibility criteria are being broadened in order to *"enable insurers to invest significantly more in long-term productive assets, especially in infrastructure"*.

  No timescales are given for these reforms, which will be made under the Financial Services and Markets Bill. See WHiP Issue 95 for background information on the consultation.

- The state pension 'triple lock' will again be applied in 2023, meaning a 10.1% increase to state pensions. Pension credit will be increased by the same percentage.
- The state pension age review, due by May 2023, will be published "in early 2023". The Autumn Statement document makes it clear that longevity is only one factor being considered:

  > *"The Review will need to carefully balance important factors, including fiscal sustainability, the economic context, the latest life expectancy data and fairness both to pensioners and taxpayers."*.

- The income threshold for paying additional rate (45%) tax (and so for being entitled to 45% tax relief on pension contributions) will be reduced from £150,000 to £125,140 from 6 April 2023. (NB Income tax rates differ in Scotland.)
- Other personal tax and national insurance thresholds are frozen until 6 April 2028, which is two years longer than previously announced.

See our Tax department's briefing for information on the wider announcements.

'Edinburgh reforms'

The Chancellor has announced a package of reforms to UK financial services regulation. These have been framed as designed to take advantage of 'Brexit freedoms' to boost the UK's financial services industry but many would still be possible with the UK in the European Union.

The content directly relevant to the pensions industry was as follows:

- As expected, the Government will lay regulations early in the new year to exclude "well-designed" performance fees from the DC automatic enrolment scheme default fund charge cap. This is intended to help such schemes to increase investment in long-term assets such as venture and growth capital and infrastructure.
- In the new year (later than previously expected), the Government will consult on a new 'value for money' framework, alongside the FCA and the Pensions Regulator, which will set required metrics and standards in key areas such as investment performance, cost and charges and quality of service that DC pension schemes must meet.
- In early 2023, the Government will consult on new guidance for the Local Government Pension Scheme (LGPS) in England and Wales on asset pooling. It will also consult on requiring LGPS funds to ensure that they are considering investment opportunities in illiquid assets, as part of a diversified investment strategy.
- There is a Government consultation on the VAT treatment of fund management services. The aim is to clarify the boundaries of the existing 'special investment fund' exemption, which can apply in relation to DC pension fund management, rather than to move away from the existing position under UK and EU retained law. For more information, see our briefing.

The Government intends to publish an updated Green Finance Strategy early in 2023. In the first quarter, it will also consult on making ESG rating providers subject to FCA regulation.

For information on the wider reforms, see our Financial Services & Markets department's briefing.

Liability-driven investment

Pensions Regulator guidance statement

The Pensions Regulator has issued a new guidance statement calling on DB scheme trustees who use liability-driven investment (LDI) to maintain an appropriate level of resilience in leveraged arrangements to better withstand a fast and significant rise in bond yields. The statement also calls on trustees investing in leveraged LDI to improve their scheme's operational governance.

The statement refers to statements by the Central Bank of Ireland and the Commission de Surveillance du Secteur Financier (Luxembourg) on resilience of LDI funds published on 30 November 2022. These are the regulators of offshore jurisdictions where many LDI funds are located. Their statements on maintaining a liquidity buffer and reducing the risk profile are aimed at pooled funds but the Pensions Regulator expects the same level of resilience to be maintained for segregated leveraged LDI mandates and single-client funds.

A detailed 'Next steps for trustees' section includes the following recommended practical steps, alongside reviewing their governance processes generally and considering the challenges that arose in September/October 2022 (but see below where the scheme has arranged a line of credit with the sponsoring employer):

> *"We recommend that trustees take the following practical steps (where relevant to their scheme) to ensure they are able to react quickly in response to stress in the market:*
>
> *1. Confirm authorised signatories are up to date and ensure that governance is sufficiently robust, and that decisions can be made at speed in stressed market conditions.*
>
> *2. Stress the non-leveraged LDI asset allocation (eg equities, corporate bonds) using a yield shock as set out by the NCAs.*
>
> *3. Stress the leveraged LDI pooled fund / segregated mandate using the same yield movement.*
>
> *4. Calculate the required collateral amounts, and the type of assets (for example, gilts, cash).*
>
> *5. Specify the dates when these collateral / margin calls need to be made.*

6. Specify what assets would be sold, when the sell instructions would need to be given, and when the cash is settled.

- *This should take account of the settlement period of the various asset classes or the dealing dates of pooled funds and any potential risk that any fund may defer redemption if they are unable to meet liquidity needs, or become considerably less liquid in such conditions.*
- *Trustees should liaise with LDI fund managers and ask for an assessment of the liquidity of the assets that the schemes intend to use to meet cash requests.*

7. Confirm who the instructions need to go by and the method of signature (electronic or wet ink).

8. Confirm that necessary collateral / cash margins can be paid on the dates specified.

9. Confirm the asset allocation post collateral / margin call.

10. Document these arrangements and review them regularly.

We also recommend that trustees continue to have detailed conversations with LDI managers on liquidity for pooled and segregated arrangements, including:

- *what the triggers for replenishment are*
- *confirming the process for meeting collateral / margin calls*
- *providing visibility of liquidity to LDI managers as appropriate"*

Where the scheme instead has a line of credit with its sponsoring employer to ensure liquidity:

> *"Such arrangements should be documented and reviewed regularly to ensure they remain in place and clearly reference the time period, amounts and conditions. The emphasis should be on immediate flow of cash if required. When such arrangements are in place, this line of credit can be used in place of investment liquidity. Any facilities must only be utilised on a short-term basis and for liquidity purposes.*
>
> *Trustees should make sure any arrangement is reviewed legally to avoid the risk of an abrupt end to the facility when it is needed."*

The Regulator plans to issue a further update in its Annual Funding Statement in April 2023 and further statements and investment guidance as necessary.

FCA statement

The FCA welcomed the above statements. It added:

> *"Since the events that occurred in the gilt market, the FCA has been working closely with its regulatory partners in the UK and across Europe. The FCA has also been engaging directly with firms involved in the management of LDI portfolios to ensure they have increased resilience to deal with possible future volatility.*
>
> *The FCA expects asset managers to take any necessary or appropriate action following these communications and that they operate their products and services in a way that will not create risks to market integrity or financial stability. Measures such as liquidity buffers are a necessary but only partial solution as there can always be events or conditions that exceed them. Managers of LDI funds should learn lessons from these events to understand and reduce the consequences in tail events. These include operational lessons, the speed with which they are able to rebuild buffers or rebalance funds, client and stakeholder engagement, and reliance on third parties.*
>
> *All market participants should factor recent market conditions into their risk management, and should adopt a wider horizon of events that might be considered extreme but plausible. As in this event, participants should also consider the risk profile and systemic dynamics of events that could conceptually occur beyond this. The FCA will maintain a supervisory focus to ensure vulnerabilities identified during the period are addressed. We are reviewing lessons learned and engaging with firms on their operational contingency planning, and intend to publish a further statement on good practice towards the end of Q1."*

Bank of England recommendation

In its latest financial stability report, the Financial Policy Committee (FPC) of the Bank of England welcomed the above statements and made recommendations as follows:

"The FPC is of the view that LDI funds should maintain financial and operational resilience to withstand severe but plausible market moves, including those experienced during the recent period of volatility. This should include robust risk management of any liquidity relied upon outside LDI funds, including in money market funds.

…

Given the identified shortcomings in previous levels of resilience and the challenging macroeconomic outlook, the FPC recommends that regulatory action be taken, as an interim measure, by [the Pensions Regulator], in co-ordination with the FCA and overseas regulators, to ensure LDI funds remain resilient to the higher level of interest rates that they can now withstand and defined benefit pension scheme trustees and advisers ensure these levels are met in their LDI arrangements.

Following this, regulators should set out appropriate steady-state minimum levels of resilience for LDI funds including in relation to operational and governance processes and risks associated with different fund structures and market concentration. Further steps will also need to be taken to ensure regulatory and supervisory gaps are filled, so as to strengthen the resilience of the sector. The Bank will continue to work closely with domestic and international regulators so that LDI vulnerabilities are monitored and tackled."

Select Committee inquiry

The Work and Pensions Select Committee is holding a short inquiry into the lessons to be learned from the gilts market turmoil and Bank of England intervention, focusing on the impact of the volatility in gilt yields on DB schemes with LDI strategies and their regulation and governance.

DB/hybrid scheme returns

The Pensions Regulator has updated its web page for DB and hybrid scheme returns, including example scheme returns and details of the changes this year. The main change relates to the information now needed on asset breakdown, which will be used by the PPF for pension protection levy purposes and by the Regulator in relation to the Pension Schemes Act 2021 funding and investment strategy regime.

DB and hybrid scheme return notices will be issued from 1 February 2023 and returns must be submitted by 31 March 2023.

Surprisingly, the example scheme return does not include confirmations in relation to compliance with the legislative requirements (formerly under a CMA order) concerning setting objectives for investment consultants and in relation to tendering for fiduciary management services. Similarly, the DC scheme return has also not yet been updated to include this. The Regulator's expectations of trustees in this regard are therefore currently unclear. The regulations, however, are clear that this compliance information is registrable information, and so we believe schemes should expect to be asked for it within their live scheme returns for 2023.

DC member outcomes

David Fairs of the Pensions Regulator has written a blog post calling on DC scheme trustees to increase their investment skills and help members to access better investment opportunities, whether in their existing scheme or by consolidation. He tells trustees to "upskill or up sticks".

After highlighting the latest changes to the requirements on DC governance and charges (value for members assessments and the calculation and publication of net investment returns), he discusses the difficulties around valuing illiquid assets. He says that the Regulator believes that trustees who are considering investing in illiquid assets should:

- *"ensure that rigorous valuation governance processes are in place and the proposed valuation data points meet the administration requirements for their scheme*
- *obtain appropriate advice from their investment adviser and their legal adviser and also, potentially consult their scheme auditor*
- *understand the difference between the use of stale and modelled prices and in which circumstance either may be acceptable or necessary*

- *undertake some member movement scenario analysis to understand the practical implications in relation to valuations and attribution of fees and performance*
- *undertake some downside valuation scenario analysis to understand the operational issues that would arise, in stressed markets or when (fund) assets invested in are subject to, for example, an audit qualification"*.

Finally, he reminds trustees to consider climate change and wider sustainability issues and the accompanying "material systemic risks" and "tremendous opportunities for investment".

Retained EU Law (Revocation and Reform) Bill

A Government minister has indicated, in committee stage Parliamentary debate on the so-called 'Brexit Freedoms Bill', that the Government intends to remove the requirements of the *Hampshire* and *Bauer* CJEU judgments from UK law. Any revocations would not affect PPF compensation in respect of insolvencies that occurred before the date of the revocation.

Labour MPs had tabled an amendment to exclude those judgments (and other worker and consumer protections) from the sunsetting provisions of the Bill and so retain their effect. The amendment was rejected but may well be raised again at a later stage or stages.

In the *Hampshire* case, the European Court ruled that the insolvency protection required under European law is an individual minimum guarantee that the affected employee or former employee will receive at least 50% of their accrued pension entitlement (see WHiP Issue 72). In *Hughes*, the Court of Appeal held that this could be assessed on an actuarial value basis, with ongoing checks not required, and that applying the PPF compensation cap to those who had reached normal pension age unlawfully discriminated on grounds of age (see WHiP Issue 90). In *Bauer*, the CJEU ruled that circumstances in which less than 100% protection is inadequate also include where, as a result of the reduction of benefits, the individual is living, or would have to live, below the at-risk-of-poverty threshold determined by Eurostat for the Member State concerned (see WHiP Issue 76).

The committee stage has now ended, with only Government amendments accepted. The next stage, which is the report stage, involves debate on proposed amendments in the House of Commons. The Government is being urged by representative organisations across various industries to drop the Bill and end the current uncertainties as to its effects.

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