

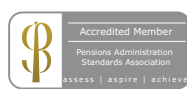
SPENCE

Your Quarterly Pensions Update Quarter Three 2024



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Welcome to your Quarterly Pensions Update

The purpose of this report is to update sponsors and trustees with recent pensions industry changes in the quarter.

For your convenience, Spence has summarised the key developments and highlighted the necessary actions sponsors and trustees may need to take.

The report combines brief written comment with links to any further relevant information and any deadlines you should be aware of. We trust you will find the update useful and informative. If you require further information about how any of the topics covered might impact on your scheme specifically, please get in touch with alan_collins@spenceandpartners.co.uk or your usual Spence contact.



Investment update

Q3-24 Market Commentary

Most asset classes delivered strong returns over the quarter as the start of the US Federal Reserve's ("Fed") rate cutting cycle was welcomed by investors as an indication that it had achieved its aim of combatting the elevated levels of inflation. As a result, Global listed Real Estate delivered the highest returns at 16.2%* with Global Bonds also delivering strong returns at 7.0%* as the prospect of lower rates going forward was positive for valuations. However, the quarter was still punctuated by a bout of market volatility when weak US economic data and an interest rate hike by the Bank of Japan ("BOJ") caused markets to sell-off in early August.

Growth Assets

Within Equities, Emerging Markets ("EM") was one of the strongest performing regions returning 8.9%* followed by Asia Ex-Japan at 4.6%, after the Chinese Government announced a raft of stimulus measures, which were positive for Asian stocks. Despite most markets performing well in local currency terms, the strong appreciation of sterling during the period dampened the performance of most markets in GBP terms with Japanese Stocks only generating 0.7% and the US market delivering -0.1% for the period. The BOJ's surprise rate hike in July caused Japanese stocks to sell-off and post a negative return in local currency terms; the significance of the rate move by the BOJ also caused a number of carry trades, which rely on cheap Japanese borrowing costs, to unwind which helped to exacerbate the market volatility we witnessed during the period. Despite the US Market generating a negative return in GBP, it still achieved a strong return in local currency terms at 5.9%*; US stocks also experienced a broadening out of returns during Q3-24 with US Value and Small Caps Stocks posting the highest returns as the dominance of the 'Magnificent 7' (the 7 largest tech stocks in the US market) was reduced. Within Europe, the UK was one of the strongest markets generating 2.3%, whilst Europe Ex-UK was flat for the period with weak German manufacturing data weighing on returns.

Commodities returns were muted during the period generating 0.7%* as growing concerns around the health of the global economy weighed on returns, mainly driven by a fall in the price of Oil.

Bonds

The start of the Fed's rate cutting cycle meant that most sovereign bond markets posted positive returns this quarter, with Italian Bonds returning 5.2%* and U.S Treasuries 4.7%*. UK and German Bonds also generated positive returns, whilst Japanese Government Bonds had the lowest returns at 1.5%* as the rate hiking cycle implemented by the BOJ weighted on Japanese bond valuations. Credit markets also experienced strong returns in Q3-24 with Global Investment Grade and EM Debt experiencing the highest positive returns at 6.3%* and 6.1%* respectively as the more interest rate sensitive credits benefited from the rate cutting cycle, although US and European High Yield also achieved positive returns at 5.3%* and 3.5%* respectively.

Within the UK, long-term UK gilt yields decreased by 0.1% to 4.5% as wider sentiment around potential rate cuts going forward put downward pressure on rates during the period. All else being equal, the move will have acted to increase the value placed on pension schemes' liabilities.

Real yields remained broadly the same at 1.3%. As a result, there won't be an impact on the value placed on inflation sensitive pension scheme liabilities.

Long-term inflation remained the same at 3.2%.

All returns shown are shown in GBP terms unless stated otherwise, sourced: FTSE, Markit iBoxx
*Local currency, except for EM and global indices, which are in US dollar, sourced: JPM and MSCI
Past performance is not a reliable indicator of current and future results.
Data as of 30 September 2024.

Pensions Review – What to look out for in DC

The Labour manifesto promised to “undertake a review of the pensions landscape to consider what further steps are needed to improve pension outcomes and increase investment in UK markets.”

When the review was launched in July, it focussed on the Local Government Pension Scheme and Defined Contribution pensions, with Defined Benefit pensions being dealt with separately. The purpose of phase one was to ‘boost investment, increase pension pots and tackle waste in the pensions system’. The second phase will also include assessing retirement adequacy.

The August phase one terms of reference included Defined Contribution policy areas such as:

- Driving scale and consolidation in defined contribution workplace schemes,
- A greater focus on value to deliver better outcomes for future pensioners, and
- Encouraging further pension investment into UK assets.

The September Call for Evidence included questions around several themes.

This included:

- The role of Single Employer Trusts,
- The relative roles of Master Trusts and Group Personal Pensions, including how the roles and responsibilities of Trustees and Independent Governance Committees (IGC) compare,
- How influential are employers, advisers, Trustees/IGCs and pension providers in setting workplace DC costs,
- Would a more consolidated, value focussed, DC workplace market increase UK investment, and
- Whether pension funds should be incentivised to invest in UK assets.

What could this mean in practice?

The government is currently consulting on a Value for Money Framework for Workplace DC pensions, including Single Employer Trusts, Master Trusts and GPPs. While costs and charges are still considered, quality of service and investment performance will also be assessed to provide an overall Value for Money rating. Pension providers not offering Value for Money could be prevented from taking on new employers.

Although initial findings from Phase one should be reported later this year, it will be a while before details are confirmed. Having said this, the intended direction of travel is clear. A more consolidated DC workplace market potentially further incentivised towards UK asset investment.

What should be considered now?

It’s unlikely that you will want to take decisions now which could be unnecessary, or even counterproductive, should future requirements differ from those currently proposed. Instead start considering whether there are any ‘no regrets’ actions you could be taking now.

Actions taken to improve member engagement should always benefit members, even if member engagement doesn’t become a relevant factor when assessing service quality.

Knowing how your scheme compares with other schemes, particularly larger schemes, may indicate whether your scheme is likely to be considered Value for Money. This could then help you decide how soon you might need to take action.

When scheduling any future scheme reviews consider whether it is likely you’ll need to make significant changes over the next few years. If you’re fairly confident about your scheme quality, then you may want to wait for further detail. If you have concerns, then you may want an earlier scheme review, so you’re as prepared as possible.

No details have been confirmed, we don't have a start date, and we don't even have interim findings. Can this simply be ignored?

Yes.....and no.

Doing nothing is always an option, and in some cases might be the best option. However, when it comes to pensions it is always advisable to be prepared for potential change. Even the possibility of legislative or regulatory change can itself cause change.

Ability to adapt will be key. This will depend on not only having a good understanding of your scheme's strengths and weaknesses, but also how they compare to the Workplace DC Market.

Helpful Links

[Chancellor vows 'big bang on growth' to boost investment and savings - GOV.UK \(www.gov.uk\)](#)

[Pensions Investment Review: Call for Evidence - GOV.UK \(www.gov.uk\)](#)

[Terms of Reference - GOV.UK \(www.gov.uk\)](#)

[Change Labour Party Manifesto 2024](#)

DB Funding Regulations

The New DB Funding Code: Key Updates for Trustees and Sponsors

The Pensions Regulator's ("TPR") long-awaited Defined Benefit ("DB") Funding Code of Practice was laid before Parliament on 29 July 2024. The Code must be laid for 40 sitting days after which, assuming no objections from Parliament, TPR will issue it in its final form. Alongside the Code, TPR has published the responses to its consultations on the Code and Fast Track, including the updated Fast Track parameters.

The Code is underpinned by legislation; in particular, the Occupational Pension Schemes (Funding and Investment Strategy and Amendment) Regulations 2024, which came into force in April 2024. The regulations apply to schemes undertaking actuarial valuations with effective dates on or after 22 September 2024.

Under the new Funding Code, for the purposes of determining their funding and investment strategy, trustees must determine the following:

Their long-term objective (which explains how they intend to provide benefits over the long-term, e.g. run-on, buyout, transfer to a consolidator).

Their Low Dependency Funding Target ("LDFT"), which will include the funding level they intend the scheme to have reached on a Low Dependency Funding Basis ("LDFB") at a particular date – known as the "relevant date". This date is set by the trustees and must be no later than the end of the scheme year in which "significant maturity" is reached.

The investments they intend to hold at the relevant date.

Where relevant dates are set in the future, details of the journey plan setting out how the scheme will progress from its current funding position to its LDFT.

The final draft Code provides greater clarity on a number of areas and introduces several significant updates. We have noted the key updates from the earlier draft code below.

Point of Significant Maturity:

A scheme reaches significant maturity when its liability duration, calculated on a LDFB, falls below a threshold number of years.

Definition of Significant Maturity: This has been set at 10 years for DB schemes and 8 years for schemes with only cash balance benefits. In the earlier draft, significant maturity was set at 12 years.

Low Dependency Investment Allocation ("LDIA"):

The Code makes it clear that the LDIA is a notional investment allocation from which a LDFB can be derived and supported.

There is a broadening of the definition of matching assets.

The Code is now less prescriptive around how trustees should test the high resilience of their LDIA but does require a suitable test to be carried out.

Simplifications for Smaller Schemes:

Ease of Compliance: Smaller schemes with 200 or fewer members can use simplified calculations, making compliance more accessible and less onerous.

There is also further commentary in the final draft Code on other matters including open schemes, recovery plans, employer covenant and journey planning.

Understanding the Fast Track Parameters

The Fast Track approach is an addition to the DB Funding Code and is designed to offer a more standardised pathway for schemes to meet regulatory expectations. If a scheme can meet a series of parameters, TPR are less likely to scrutinise the actuarial valuation submission.

Key Fast Track Parameters:

Low Dependency Funding Basis: This basis is more prescriptive under Fast Track. In particular, the maximum discount rate is set as gilts plus 0.50% p.a.

Strength of the Technical Provisions ("TPs") Basis: A scheme's TPs must be at least a minimum level relative to the LDFB. For illustration, at a duration of 20 years, the TPs must be at least equal to 83.5% of the LDFB liabilities, at 15 years this is 92% and at 10 years (significant maturity) it is 100%.

Stress Test: When stressed, the scheme's funding level must not fall by more than a set percentage. The longer the duration, the greater the allowance for a drop in funding level.

Recovery Plan Lengths: No longer than 6 years for schemes before their relevant date and 3 years for schemes at or after their relevant date.

Open schemes: The duration calculation can include an allowance for future service of no more than 9 years of future accrual. For schemes open to new entrants, the assumed number of new entrants to the scheme should not exceed the average level of new entrants over the 3 years preceding the current valuation.

Next Steps for Trustees and Sponsors

Stay Informed: The full details, including the consultation responses, are available on TPR's website. Spence can also provide in-depth training to you on the new requirements.

Review Current Funding Strategies: Evaluate your scheme's current funding strategy against the final draft DB Funding Code and Fast Track parameters. Spence can prepare a health check to test how well your scheme meets the new requirements.

Engage Your Advisers: Work closely with your scheme actuary, investment consultant and covenant adviser to develop your long-term objective and journey plan to reach that destination.

At Spence, our expert team is ready to support trustees and sponsors navigate these regulatory changes to ensure compliance. Contact us today to learn more about how we can assist you in adapting to the new DB Funding Code and Fast Track requirements.

Helpful Links (links not provided in Word doc)

[Draft defined benefit \(DB\) funding code of practice and regulatory approach consultation | The Pensions Regulator](#)

[Response to Fast Track and regulatory approach consultation | The Pensions Regulator](#)

[Response to our draft DB funding code of practice consultation | The Pensions Regulator](#)

Buy-out, risk transfer, end game

Searching for your Endgame

– Have you checked in all the cupboards?

The phrase “Endgame” has crept into being core terminology within the pensions world, but what should Trustees and Sponsors of DB Pension Schemes in the UK really be considering when it comes to developing and implementing their endgame of choice?

Well, the choices are growing and evolving for endgames and unintuitively, an endgame strategy may move from one solution to another as your scheme matures, evolves and risk-profiles as well as economies-of-scale change.

Legislation does not prescribe what a scheme’s endgame should be and normally neither will the scheme’s trust deed and rules. This means that trustees need to make a decision. In practice what each trustee board, usually working with the sponsor, will decide is right for its scheme will vary.

All trustees will execute their endgame by exercising a power from the scheme’s trust deed and rules. Therefore, any strategic target-setting should have regard to the relevant powers and how they may be exercised. However, when exercising any power, trustees have to make sure that the use of that power meets the “proper purpose” test.

Trustees have to make sure they use the relevant power in the way that it was intended. So for endgame planning trustees need to ask themselves “what is the purpose of the scheme?” and this can be broadly summarised as “providing the benefits the employer promised in a cost effective way”. This is a key consideration when looking at any endgame.

What do trustees need to take into account when deciding on an endgame?

One factor which always needs to be taken into account is the security of members’ benefits. Trustees are not legally obliged to choose the endgame solely on the basis of which option would provide the maximum level of security for members’ benefits. The legal question is whether the endgame provides a sufficient degree of certainty for members’ benefits.

So, what should a trustee’s endgame be?

There is no one size fits all. When considering any endgame trustees should look at the different options available and weigh up what they consider to be the most appropriate at that time taking into account all of the relevant factors. Trustees will not be judged for any decision with the benefit of hindsight provided they have followed proper process and acted reasonably at the time.

Fundamentally there are three main categories of endgame:

1. Self-sufficiency often referred to “run-on” or “run-off”;
2. Consolidation (either through “settlement” [transferring the risk] or on an “operational” [retaining the risk] basis);
3. Risk transfer or “buyout”.

The recent change in Government could influence or modify your current views on preferred endgame, and this will almost certainly evolve following the Autumn Budget announcements in respect of pensions expected on 30 October 2024. So, perhaps it is worth revisiting your hunt through endgame cupboards once the dust has settled?

So, before you fully commit to a particular endgame, please make sure you’ve looked in every cupboard to ensure you have appropriately explored the options!

Corporate accounting

Corporate accounting: Defined Benefit (DB) schemes pensions update

Companies with December year ends will be starting to plan the year end process. What can they expect, and what should they do to prepare, for their DB pension disclosures?

Improved funding positions

Based on market conditions at 30 September 2024, companies can expect an improved funding position on their DB pension scheme, and in many cases surpluses will be larger than last year end, all else being equal. The table below shows some key market indicators for DB pension accounting, and how they have moved since 31 December 2023. The rise in corporate bonds yields and strong performance of most asset classes means that companies should expect to see an improvement in the FRS102 funding position since last year end in most cases.

Metric	31 Dec 2023	30 Sep 2024	Comments
Liability side:			
AA 15+ corporate bond yield	4.5%	5.1%	Reduces liabilities by 9% for a 15 year duration
15 year market implied RPI	3.4%	3.4%	No significant change to liabilities
Asset side:			
Equities	Up over 10%		Most asset classes up other than bonds that are down marginally reflecting the rise in yields.
Multi Asset Credit	Up c. 5%		
15+ index linked gilts	Down c. 4%		

Key considerations for employers

Given the improved funding positions, the key considerations for employers this year end are:

Review the recoverability of your DB surplus (if you have one) and whether a DB surplus should be recognised on your balance sheet. The ability of an employer to recognise pension surplus on the balance sheet depends on the powers under the scheme rules. DB surpluses can ordinarily be recognised unless accessing a surplus, either on wind-up of the scheme or after payment of the last pension has occurred, is outside the control of the employer. There has been some movement in interpretation here over the last year, particularly for employers in LGPS funds.

If risk transfer activity has taken place over the year (e.g. a buy-in or a buy-out), be clear on the accounting implications of this activity. Auditors can have different opinions on when a risk transfer transaction becomes a settlement item rather than an investment decision. Generally a buy-in is considered an investment decision, and a buy-out is a settlement. If a settlement is expected next year, consider carefully the assumptions used at this year end, and the value placed on the liabilities, as this will drive the size of the settlement loss next year.

Take actions to minimise the level of auditor queries and streamline your pensions accounting process. If corporate accounting deadlines are tight, consider engaging with your actuary and auditor in advance of the year end to agree the principles for setting the assumptions and tackle any initial auditor queries. More broadly, the improvement in funding positions and shrinking of DB schemes in recent years, means pensions disclosures are less material than previously. There is less value in looking to 'stretch' assumptions, possibly unless looking to manage the size of a settlement loss on risk transfer. Instead, consider taking a standardised approach that will be sufficient to meet your auditor's requirements.

Pensions Dashboards – The time to engage is now

Time to first staging date: 6 months (30 April 2025)

While the legal backstop date of 31 October 2026 remains, tPR is providing strong messaging that they expect pension schemes to connect by their staging dates, and that not doing so is likely to raise the risk of trustees not complying with their dashboard obligations.

It may seem that staging dates are still far away, but there is work to be done to ensure schemes are ready to stage. Trustees have to engage now.

What should Trustees be asking administrators?

- How much work is required to calculate the Estimated Retirement Incomes for each member? Is there work required to have the correct data? Is there work required to automate calculations? Is this work required once or annually?
- What interface will we be using to connect to the dashboard and what is the cost of this? Is this a one-off cost or recurring?
- What ongoing costs will there be for maintenance and testing?
- Will there be additional costs if more members contact the administrator as a result of the dashboard going live?
- Are there any projects that we need to get completed prior to connecting to the dashboard? GMP equalisation, data audit, benefit audit etc.
- What is our scheme specific timeline for doing the work required to meet our staging date?

Trustees have to take control now to make sure they understand what needs done, the timescales, and the costs to ensure that staging dates will be met.

Dashboard Standards

Some pension dashboard standards have recently been updated. The standards can be found [here](#). The standards set out the data and technical information required to display estimated retirement incomes and connect to the dashboard, along with design and reporting standards.

These can be a helpful tool for Trustees to understand what is required and also to question providers on how progressed they are with compliance.

Cyber Security

In today's hyper-connected world, institutions that hold large quantities of personal data or who hold transactable financial assets are attractive to fraudsters and other bad actors. Pension schemes are both of those things and therefore present a major target.

The UK pensions industry has seen major level cyber security breaches in recent years, particularly in the well-publicised incident involving Capita.

It's therefore essential that pension scheme trustees have a strong understanding of how cyber security risk presents itself, and what steps they (and their service providers) can take to manage these risks.

TPR set these out in their "**Cyber security principles for pension schemes**" as follows:

You must make sure that you:

- **understand your scheme's cyber risk**
- **ensure that those handling data or managing technology on your behalf have controls in place to reduce the risk of incidents occurring and their impact**
- **manage incidents that arise**

Cyber Security is a key part of a scheme's Effective System of Governance (ESoG).

At a high level, cyber security risks can be categorised into the following (non-exhaustive) buckets:

- The risk that member or scheme data is accessed, extracted, or changed in some manner
- The risk that access to all or some services (e.g. payroll) is disrupted
- The risk that cash is extracted from the pension scheme by an unauthorised third party

Cyber-attacks can take many forms, and the ease of use of generative AI is likely to continue to evolve new methods.

A strong defence against cyber risks needs to encompass both reducing the risks of cyber incidents occurring, and how any incidents that do occur are notified, managed and learnt from.

Trustees need to consider a wide range of areas where cyber risk can occur – in a pension scheme it is not uncommon for data to be shared with a variety of providers (administrators, actuaries, payroll bureaus, employers, auditors) and each provider will itself be reliant on their own range of service providers for IT and networking services. Furthermore, when suppliers change, it is common that data is retained for a period of time, meaning that exposure to cyber risk may include exposure from former as well as current suppliers. Assessing risk across the scheme can therefore be a relatively complex job requiring time and thought.

Fortunately, a number of standardised certifications and audits are available, for example Cyber Essentials, Cyber Essentials Plus, and ISO27001. Spence hold all these certifications.

TPR also suggest Trustees should discuss and agree an incident response plan to any cyber security breaches. This would include details of notification pathways and member communications. It can also include contingency plans if an incident interrupts a key service.

Cyber Risk isn't new. But it isn't going away and is continually evolving. By working with suppliers with good standards of control and having clear plans in place to deal with incidents, Trustees can be confident they are complying with their regulatory requirements and are doing their best to protect member data and scheme assets.

Coming Up Next

We are now a few months post the 2024 General Election and pensions has never been far from the news. We've finally seen the launch of the much anticipated new DB funding regime and the Labour Government has also announced a Pensions Review.

We set out below some of the key events we expect to happen over the coming months and years.

New DB Scheme Funding Regulations

We have to start with this one. The final draft of the DB Funding Code of Practice was finally laid before Parliament at the end of July. No further changes are anticipated and this new code will apply to actuarial valuations with effective dates on or after 22 September 2024.

TPR has also helpfully published template Statement of Strategies that trustees and employers will need to complete and submit as part of the new valuation process once the new digital service is live in Spring 2025

However, it's not quite the end of the story. Further guidance relating to assessing the employer covenant and advice for Scheme Actuaries is also expected over Q4 2024.

Pensions Review

As noted in the pre-election manifesto, Labour promised a Pensions Review on their election. The review is split into two phases and covers the following areas:

Phase 1

- Driving scale and consolidation of defined contribution workplace schemes;
- Tackling fragmentation and inefficiency in the Local Government Pension Scheme through consolidation and improved governance;
- The structure of the pensions ecosystem and achieving a greater focus on value to deliver better outcomes for future pensioners, rather than cost; and
- Encouraging further pension investment into UK assets to boost growth across the country.

A call for evidence recently closed on 25 September.

Phase two

- Expected to start later this year and will consider further steps to improve pension outcomes, including assessing retirement adequacy.

Collective Defined Contribution (CDC) Schemes

The Occupational Pension Schemes (Collective Money Purchase Schemes) (Amendment) Regulations 2024 have very recently come into force with Royal Mail launching the first such CDC scheme in the UK. This was followed by government consultation on legislation which would allow for multi-employer CDC schemes.

It remains to be seen whether CDCs will catch on more widely in the UK or whether they will end up being the preserve of the larger schemes.

Here are some key dates to keep in your diary as move towards the end of 2024 and into 2025:

November 2024

Lifetime Allowance Abolition

The final legislation to complete the removal of the Lifetime Allowance should come into force on 18 November 2024, backdated to 6 April 2024.

January 2025

Occupational Pension Schemes (Revaluation) Orders

The latest Occupational Pension Schemes Revaluation Orders will come into force on 1 January 2025.

February 2025

A court case is expected to discuss similar questions to those raised as part of the Virgin Media case (see below) first heard in 2023 and appealed (unsuccessfully) in June 2024.

In the Virgin Media case (Virgin Media Ltd v NTL Pension Trustees II Ltd), broadly speaking, the High Court ruled that benefits amendments made to contracted out schemes during the 6 April period 1997 to 5 April 2016 may be void in the absence of a particular confirmation known as a "Section 37 confirmation" relating to the protection of member contracted out rights.

April 2025

1st : Pension Protection Fund (PPF) Levies 2025/26

Start of PPF Levy Year for 2025/26. Invoicing will take place in the Autumn.

Pension Scheme Dashboards

The first pension schemes are expected to connect to the Dashboards Ecosystem.

Social Security Benefits Up-rating

Up-rating Orders are produced each year and specify the rates of various Social Security benefits for the coming tax year. The next orders are expected to take effect from April 2025.

GMP Increase Order

The percentage increase by which that part of Guaranteed Minimum Pensions (GMPs) attributable to earnings factors for the tax years 1988–89 to 1996–97 and payable by contracted-out, DB occupational pension schemes is expected to take effect.

September

PPF consultation on 2026/27 Levy rules

PPF expected to publish its consultation on the 2026/27 levy rules

'And beyond'

31 October 2026: Pensions Dashboards

Pensions Dashboards connection deadline.

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