HERBERT SMITH FREEHILLS

PENSIONS PLANNER

YOUR GUIDE TO FUTURE DEVELOPMENTS

SUMMER 2024

Contents

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Introduction

At the end of the period covered by this Planner, a curveball: Rishi Sunak chose to "go early", announcing a general election for 4 July – the UK's first summer poll since 1945.

The election comes at an interesting time for occupational pension schemes. DC schemes have achieved real collective scale. Total assets stand at about £150bn, up from just £22bn in 2012 when auto-enrolment was introduced. On the DB side, as discussed in this Planner, there have been two significant developments. Many schemes now find themselves contemplating surpluses, rather than grappling with deficits. Meanwhile for schemes which still face funding challenges, new endgame options are emerging. Clara has agreed its second major transaction, while the Pension Protection Fund has published thoughts about acting as a public sector consolidator.

Against this background, Labour's manifesto pledges "to ensure that workplace pension schemes take advantage of consolidation and scale", so as to deliver "greater productive investment in UK PLC". The Conservatives promise to push ahead with the Mansion House reforms, which are intended (likewise) to increase investment in productive finance. The outgoing Government had published proposals to that end, including measures to promote consolidation.

There is a good deal of common ground here. Both parties have concluded that, with scale and improved funding levels, pension schemes can play a part in boosting UK growth. But getting there will not be straightforward. The purpose of a pension scheme is to deliver benefits for members, not to promote the wider economic good. If the next Government wants to achieve a step-change in asset allocations, trustees will need to be persuaded that an increase in "productive" investment can be squared with their duties to members and employers.

With thanks to Michael Aherne and Annabelle Stoney for their help in preparing this quarter's Planner.

Richard Evans, Professional Support Lawyer

Quarter in review

New funding regime: TPR consults on statements of strategy

As anticipated in our Spring Pensions Planner, Regulations implementing the new defined benefit funding regime came into force on 6 April 2024, but with a breathing space: the new regime applies only to valuations with an effective date on or after 22 September 2024.

On 5 March 2024 The Pensions Regulator (**TPR**) launched a consultation as to the statement of strategy required under the new regime. The consultation closed on 16 April 2024.

Background

Key to the new regime is a requirement for trustees to determine a funding and investment strategy (**FIS**). The FIS is a plan to reach low-dependency funding by a specified date (the **relevant date**), not later than the point at which the scheme is expected to reach significant maturity. Having determined the FIS, trustees must produce a statement of strategy, made up of two parts:

- Part 1 sets out the FIS. This part is subject to employer agreement.
- Part 2 covers supplementary matters, including progress towards implementation of the FIS, attendant risks, and how those risks are being managed. Trustees must consult the employer about Part 2.

The statement of strategy must be in a form specified by TPR. TPR has power to determine the level of detail which Part 2 must include.

Trustees will have to submit their statement of strategy to TPR along with other valuation documents. TPR has said that it will adopt a twin-track approach to the assessment of valuations: "fast-track" in cases where specified conditions are met, and "bespoke" in other cases. "Bespoke" valuations will typically be subject to greater scrutiny.

TPR's proposals

TPR proposes that the form of the statement of strategy should be standardised, with trustees using one of four different templates, depending on whether they are taking the fast-track or the bespoke approach, and on whether their scheme has reached its relevant date. TPR has published a draft template for a "bespoke" valuation where a scheme has not reached its relevant date.

TPR envisages that the statement of strategy will cover (among other things) the following:

- Whether the trustees intend (in the long-term) to provide benefits by run-off, by buy-out, via a superfund, or via another consolidator.
- The intended asset allocation at the relevant date, as between "matching", "growth" and "hybrid" assets.
- Details as to actuarial assumptions – discount rate (including yield curves where relevant), mortality and commutation.
- Information about maturity, including projected cashflows over the next 100 years.
- Details as to the current investment allocation and investment risk, and (in bespoke cases) liquidity and the de-risking strategy.
- Details as to the employer covenant, including reliability and longevity periods, and (in bespoke cases) analysis as to employer cashflows and liquidity and any contingent assets.

With an eye to proportionality, TPR intends to disapply some elements for small schemes (potentially those with fewer than 100 members or less than £30m of "section 179" liabilities).

> **Comment:** TPR's proposals have met with some pushback within the pensions industry. The main point raised is that trustees and their advisers may find themselves having to generate information purely for the purpose of the statement of strategy. There are also concerns about the burden for industry-wide schemes, where (subject to certain concessions mentioned in the consultation document) trustees might need to supply information about many different employers.
>
> Whatever the outcome of the consultation, the direction of travel under the new funding regime is clear. Trustees and their advisers will be required to take a more granular approach, particularly in assessing the employer covenant. As to this, a further steer from TPR will be provided shortly: the consultation paper states that "our covenant guidance is expected in the summer".

TPR's annual funding statement

On 24 April 2024, TPR published its annual funding statement for trustees and sponsors of DB schemes. The statement is particularly relevant to schemes with valuation dates between 22 September 2023 and 21 September 2024 (**T19 schemes**). Key messages are:

- Most T19 schemes will have seen material improvements in funding levels. Half are expected to have reached full-funding on a buy-out basis. This step-change gives trustees and employers an opportunity to reassess their long-term targets.
- Where funding levels have improved significantly, trustees should consider whether their existing funding and investment strategy is still in the best financial interests of members, or whether they should adopt a different strategy aligned with their plans for the scheme.
- Trustees facing calls from employers to suspend contributions, or calls from members to grant discretionary pension increases, should consider the scheme's overall position, including the level of investment risk and the employer covenant.
- A sizeable minority of T19 schemes are expected to still be in deficit on a technical provisions basis. Trustees of these schemes should focus on achieving a recovery plan which is as short as reasonable, based on affordability. They will also need to pay careful attention to the employer covenant.
- Trustees should allow for climate and sustainability risks when determining funding and investment strategies and assessing the employer covenant.

> **Comment:** T19 valuations will be carried out under the "old" funding regime. The new regime, and the expected new DB Funding Code, will apply only to valuations with an effective date on or after 22 September 2024. However, TPR suggests that trustees of T19 schemes should "consider the steps they can take now to align (even if broadly) with the new Code when it is published", to avoid having to make significant changes at their next valuation.

Lifetime allowance abolished

The pensions provisions of the Finance Act 2024 came into force on 6 April 2024. As discussed in our Spring Pensions Planner, the Act abolishes the lifetime allowance and introduces two new allowances in its place – the lump sum allowance and the lump sum and death benefit allowance. The Act also introduces a new form of authorised payment, the pension commencement excess lump sum (**PCELS**).

On 12 March 2024, Regulations were laid which made various incidental changes. Among other things:

- The PCELS definition, which HMRC had acknowledged to be defective, was changed. The "permitted maximum" was deleted, so that there is no longer a ceiling on the amount which can be paid. Other conditions still apply. In particular, a PCELS can be paid only in connection with a relevant pension, and only where the member has exhausted their lump sum allowance or lump sum and death benefit allowance.
- A tweak has been made to Regulations under the Pensions Act 1995, to ensure that payment of a PCELS does not breach the general restriction on the commutation of pensions.
- A provision has been introduced in a bid to avoid unintended "uncapping" under scheme rules. Broadly speaking, the provision is engaged if scheme rules cap benefits by reference to the lifetime allowance. However, it is at best a stopgap; it ceases to apply in April 2029.

HMRC has continued to issue newsletters covering the tax changes and related "FAQs". HMRC has also begun to update its Pensions Tax Manual.

Newsletter 158 indicates that HMRC intends to issue a further set of Regulations making incidental changes. The changes will relate mainly to specific protections and overseas transfers. HMRC say the changes "will not affect the vast majority of pension savers".

Newsletter 159 flags a remaining concern about pension commencement excess lump sums: the payment of a PCELS may not be consistent with legislation for former "contracted-out" schemes.

Separately, an Order implementing the reduction in tax on surplus refunds was made on 7 March 2024. From 6 April 2024, the tax rate is 25% rather than 35%.

General Code now in force

The General Code, discussed in our Spring Pensions Planner, is now in force. The relevant Order took effect from 28 March 2024.

Spring Budget: proposals to build on existing initiatives

The Chancellor presented his Spring Budget 6 March 2024, calling it "a budget for long-term growth". The main pensions announcements were as follows:

- The Government would bring forward requirements for DC schemes to report publicly on asset allocations, including investment in UK equities. Similar requirements would be introduced for the Local Government Pension Scheme. The Government would consider what action to take if the reports did not show that UK equity allocations were increasing.
- The Government was working with TPR and the FCA on the proposed new value-for-money framework. TPR and the FCA would be given new powers to deal with schemes which persistently offered poor member outcomes.
- The Government would continue to explore a "lifetime provider" model for DC schemes.
- The Government would maintain the "triple lock" for the State pension.

Clara agrees second superfund transaction

On 14 March 2024, consolidator Clara-Pensions announced that it had agreed its second transaction. The new deal relates to the £600m Debenhams Retirement Scheme (**DRS**), which has been in PPF assessment since the retailer entered administration in 2019.

10,400 DRS members will transfer to the Clara Pension Trust (**CPT**), with CPT committing to provide their benefits in full. CPT will also make back-payments to remedy any benefit reductions which applied during assessment.

Clara will provide £34m of capital to support the security of members' benefits, with CPT targeting a full buy-out in five to 10 years' time.

> **Comment:** Clara's second transaction is similar in scale to the first, but the circumstances are rather different. The first transaction was with an ongoing scheme. Here there was an added complication – DRS was in PPF assessment.
>
> The demand for consolidation is clearly there. Still awaited is a statutory framework for the authorisation and supervision of consolidators, more than six years after this was first proposed by the DWP.

PPF addresses concern about assessment valuations for small schemes

Following a six-week consultation, the Pension Protection Fund announced a change to its rules for valuations of schemes in PPF assessment (**section 143 valuations**). The change will take effect from 31 May 2024.

A section 143 valuation is used to determine whether the scheme of a failed employer is fully-funded on the PPF basis (that is, by reference to the level of compensation which the PPF would pay to members). A scheme which is found to be underfunded falls into the PPF. A scheme which is found to be fully-funded exits assessment; the trustees then seek to provide benefits which exceed PPF compensation, by means of a buy-out (**PPF+**).

There is a concern that the standard basis for section 143 valuations may not produce the "right" result for small schemes. Buy-out pricing tends to be significantly higher for small schemes than for large schemes. Some small schemes which are fully-funded on the standard section 143 basis may exit assessment but then find that they are unable to afford a PPF+ buy-out.

To address this, the PPF is introducing a facility whereby, if the PPF allows, an actuary will be able to use a bespoke discount rate, rather than the PPF's standard, when carrying out a section 143 valuation.

Comment: The change potentially allows small schemes' section 143 valuations to reflect the reality of buy-out pricing. The PPF has said that it does not intend to allow bespoke discount rates for larger schemes.

Note that the change applies only to section 143 valuations. It does not affect the section 179 valuations which are used to determine PPF levies.

PPF publishes views about consolidator role

As discussed in our Spring Pensions Planner, on 23 February 2024 the DWP launched a consultation which, among other things, proposed the establishment of a public sector consolidator, to be administered by the PPF.

Shortly afterwards the PPF published a discussion document, setting out its views about how the consolidator might be structured. On 19 April 2024 the PPF issued an updated version and a response to the DWP consultation.

The PPF envisages that the consolidator would:

- be a statutory fund, managed by the PPF board but legally separate from the existing compensation fund, with no cross-subsidy or pooling;
- operate on a non-sectionalised basis, to maximise efficiencies and economies of scale;
- aim to run on (rather than to buy out), so that, within a set risk budget, it can invest in growth assets including UK productive finance;
- be required to accept transfers from all schemes which can meet its terms, ensuring that it provides a solution for schemes unattractive to commercial providers;
- provide members of transferring schemes with the actuarial equivalent of their full scheme benefits, through a number of standardised benefit structures (the discussion document includes a potential "menu");
- be required to provide at least the same level of security as that expected of commercial consolidators, with underwriting (up to a specified limit) coming from the Government;
- allow entry for a scheme which was in deficit on its basis, subject to the employer agreeing to clear the calculated amount over time; if the employer failed to clear the calculated amount, benefits for relevant members would be reduced (subject to a minimum based on PPF compensation); and
- give trustees the option to use panel firms, to drive down the cost of transacting.

The consolidator proposition would (in the PPF's view) be most compelling for the very smallest schemes – those with fewer than 100 members. The total potential market might comprise 2,300 schemes with assets of £130bn.

The PPF suggests that, if the Government takes on the role of underwriter, then it could have a say as to the consolidator's investment strategy, including the allocation of assets to productive finance.

Comment: The potential market for the consolidator is substantial, but it is not clear how many schemes would ultimately transact. Some schemes will no doubt buy out benefits with insurers. For others, alternative endgame solutions are emerging.

Against this background, the PPF warns there is no guarantee that the consolidator will become large enough to invest substantially in productive finance. If the Government want to ensure that the consolidator achieves significant scale, "changes to the proposition are likely to be needed".

Recoupment – Ombudsman lays down markers as to his approach

On 24 April 2024, The Pensions Ombudsman issued a determination in a case concerning the Bic UK Pension Scheme and a Mr E. Mr E's pension had been overpaid. The determination includes extensive discussion and analysis of the law relating to recoupment – the recovery of overpaid pension by deduction from future payments.

The Scheme's trustees decided in 1991 to improve benefits by introducing RPI-based increases for pensions in excess of GMP (**Pre-97 increases**). The Scheme was administered accordingly for the next 20 years, but the requisite rule amendment was never made. The discrepancy came to light in 2011. In 2013, members were alerted to the issue and Pre-97 increases were suspended. In 2019 the Court of Appeal held that the Pre-97 increases had not been validly granted.

Mr E's pension had, in the light of the Court's decision, been overpaid for a period of 24 years. The Trustees sought to recover part or all of the overpayment by recoupment. Mr E disputed their right to do so.

The Ombudsman held that there were two key questions:

- **Was it equitable to permit recoupment in the circumstances?**

  The Ombudsman said that, while change of position and estoppel might not be available as a specific defence to recoupment, they were relevant when considering whether recoupment should be permitted.

  The Ombudsman discussed the principles as to change of position, estoppel by representation and estoppel by convention, including their application in cases where an overpayment has resulted in a general improvement in lifestyle.

  In the leading case on estoppel by representation, the judge had said that the courts should lean against finding an estoppel in favour of particular members, because to do so would be to favour those members over other members of the scheme. In the Ombudsman's view this point did not apply in Mr E's case. The employer continued to stand behind the Scheme, and therefore an estoppel in Mr E's favour would have no direct effect on other members' benefits.

  The Ombudsman ruled that recoupment was permissible only for benefits paid after 1 August 2019. The evidence indicated that from that point onwards Mr E was aware of the Court of Appeal's ruling and had reduced his spending in the light of it.

- **Was a "laches" defence available?**

  Under the principle of laches, trustees may be barred from pursuing the equitable right of recovery if they have unduly delayed doing so.

  After surveying the caselaw about laches, the Ombudsman applied "the more modern formulation": the question was whether, taking account of the length of the delay, the reasons for it and the consequences, it would be unconscionable to permit recovery.

  The Ombudsman ruled that there had been undue delay by the trustees after the discrepancy came to light in 2011. In the following years members had been "left in limbo", with the issue inadequately explained and with overpayments continuing to build up. It would be unconscionable to permit recovery for the period prior to 1 August 2019 (the date when Mr E reduced his spending), so for that period a laches defence applied.

Of the total overpayment of £90,934, the trustees were permitted to recoup £6,554. To do so they would need to obtain a County Court order, based on the Court of Appeal's ruling in the CMG case, though this could be done without the need for a hearing.

Comment: Although not legally binding, the determination lays down a marker as to how the Ombudsman will approach disputes about recoupment.

Overpayments are not unusual, and recoupment is a valuable remedy. But it is not a magic bullet: depending on the facts, members may be able to make out a defence.

The issues will be particularly significant where, as in this case, a longstanding practice is found to have been inconsistent with a scheme's rules, such that many members have been overpaid. Under the BIC Scheme about 200 pensioners had received the Pre-97 increases, although it seems that all but a handful had accepted recoupment and had agreed recovery plans with the trustees.

Court of Appeal considers SIPP provider's duties and Ombudsman's role

The Court of Appeal has dismissed a claim for judicial review of a ruling of the Financial Ombudsman Service. The judgment in *Options UK Personal Pensions v FOS* was delivered on 20 May 2024.

Options UK Personal Pensions (**Options**) established and ran an execution-only self-invested personal pension plan. Options was authorised as a SIPP provider by the Financial Conduct Authority.

An unregulated Spanish company, CLP, introduced members to the SIPP. CLP persuaded a Mr Fletcher to transfer his pension pot to the SIPP and to invest in a storage unit scheme, Store Pods.

Options carried out only limited due diligence as to CLP and Store Pods. Mr Fletcher signed forms acknowledging that Options' role was execution-only, and agreeing to indemnify Options against liability arising from the Store Pods investment.

The investment failed and Mr Fletcher lost his pension pot. He made a complaint to the FOS about Options. The Ombudsman upheld his complaint, saying that, having regard to the FCA's principles and guidance and best practice, Options should have carried out more thorough due diligence. The terms which Mr Fletcher had agreed with Options did not relieve the firm of its obligations in this regard.

Options sought judicial review from the High Court. When the application was refused, Options turned to the Court of Appeal.

The Court of Appeal dismissed the claim. The Court held that:

- The Ombudsman had not erred in law in finding that Options had a duty to carry out due diligence as regards introducers and investments, even though the SIPP was execution-only and Options was not authorised to provide advice.
- As to the steps which Options should have taken to discharge its duty, the Ombudsman's decision could not be said to be irrational.

Comment: SIPP providers wishing to ascertain their duties will study this judgment alongside the other one to which it refers, **Adams v Options UK**. Mr Adams, like Mr Fletcher, lost money after investing in Store Pods under the Options SIPP.

For the wider pensions industry, the Court of Appeal's ruling highlights two important points:

- The Ombudsman is not required to determine a complaint in accordance with the common law. Legislation gives the FOS a much wider jurisdiction, namely to determine what is fair and reasonable in all the circumstances of the case.
- When determining what is fair and reasonable, a breach of the FCA's principles will be a relevant factor, even though such a breach is not actionable in itself.

Dashboards: staged timetable and other developments

On 25 March 2024, the Department for Work and Pensions published guidance on dashboard connection, including a staged timetable.

The ultimate deadline for connection is 31 October 2026, but schemes are expected to connect by earlier dates. These dates are set out in the staged timetable. The applicable date depends on a scheme's size (broadly speaking, the number of active and deferred members) and type. For larger schemes, the timetabled dates are in Q2-Q4 2025. For smaller schemes, the timetabled dates are in Q1-Q3 2026.

Connection by the timetabled date is not mandatory, but trustees and providers are required to have regard to the guidance. A failure to connect by the timetabled date may prompt questions about whether the trustees or provider have complied with their dashboard duties generally.

Separately:

- On 12 April 2024, the DWP published **guidance** on calculating the "annualised accrued value" of money purchase pots for dashboard purposes. The annualised accrued value is (broadly speaking) the income which the current pot might secure in retirement, disregarding future investment returns.
- The Pensions Dashboards Programme published a **progress update report** on 26 April 2024. The report states that PDP is preparing guidance on connection, and will develop an online connection hub and a code of connection (to be published later in 2024).
- An **update** from the Pensions Administration Standards Association, dated 13 May 2024, indicates that PASA is preparing guidance on administration readiness, AVCs, matching and testing.
- The Financial Conduct Authority conducted a **consultation** about proposed rules and guidance for dashboard providers. The consultation closed on 8 May 2024. The FCA plans to publish finalised rules in Q4 2024.

General election announced

Following an announcement by the Prime Minister on 22 May 2024, a general election will take place on 4 July. Parliament was prorogued on 24 May and was subsequently dissolved.

Two pensions-related Bills were lost when Parliament was dissolved: the Pensions (Special Rules for End of Life) Bill and the State Pension Age (Compensation) Bill. Some other expected developments may be delayed as a result of the election. Our blog post discusses the implications for the scheme funding regime.

Manifestos for the election were published in June. The Conservative, Labour and Liberal Democrat parties all promised to retain the "triple lock" for the State pension. Beyond that there were few substantive pensions proposals, and no major surprises.

The Conservatives' package includes:

- "triple lock plus" – a special income tax allowance for pensioners, such that the State pension is always within the tax-free threshold; and
- a "Pension Tax Guarantee", whereby the Government would not introduce any new taxes on pensions.

Labour propose:

- action to increase investment in UK companies by pension schemes; and
- a wide-ranging review of the "pensions landscape".

The Liberal Democrats promise:

- to require pension schemes to show that investments are consistent with the Paris accord, and give new powers to financial regulators as regards climate risks; and
- to ensure that "WASPI" women are fairly treated and compensated in respect of changes to State pension age.

Find our podcast about the manifestos here.

We anticipate that the new Parliament will first meet on 9 July 2024, with the State opening and King's Speech following on 17 July.

Timeline

17 July 2024
King's Speech

Expected date for King's Speech, outlining new Government's planned legislation

22 September 2024
New funding regime

New regime applies to valuation dates from 22 September 2024 onwards. TPR is expected to publish the DB Funding Code in summer 2024

April 2025 to September 2026
"Connect by" dates for dashboards

These are the expected connection dates specified in the DWP's staged timetable. The applicable date depends on a scheme's size and type

31 October 2026
Longstop date for dashboards

This is the mandatory deadline for connection

2026-2028
State Pension Age

Increases to 67

6 April 2028
Increase in normal minimum pension age

NMPA increases to 57. The change affects people born after 6 April 1971

2030
Indexation

RPI to be aligned with CPIH, with no compensation for holders of index-linked gilts

In the spotlight

Next 3 months

Virgin Media v NTL Pension Trustees

A Court of Appeal hearing in the Virgin Media case has been fixed for 25 June 2024, and is expected to last for two days. The grounds for appeal have not been published.

Our Autumn Planner explained the background. The case is of industry-wide significance, and concerns the need for actuarial confirmation in respect of changes made to benefits under schemes which were contracted out on the salary-related (**COSR**) basis. Trustees of former COSR schemes will need to consider the Court of Appeal judgment in connection with amendments made between April 1997 and April 2016.

BBC v BBC Pension Trust

Also commencing on 25 June 2024, and expected to last for three days, the Court of Appeal will hear the BBC's appeal against last year's High Court ruling regarding the interpretation of the BBC Pension Scheme's amendment power.

Notes

Notes