HERBERT SMITH FREEHILLS

PENSIONS PLANNER

YOUR GUIDE TO FUTURE DEVELOPMENTS

WINTER 2024

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Contacts

Samantha Brown
Managing Partner EPI (West)
T +44 20 7466 2249
samantha.brown@hsf.com

Michael Aherne
Partner
Pensions
T +44 20 7466 7527
michael.aherne@hsf.com

Richard Evans
Professional Support Lawyer, Pensions
T +44 20 7466 6320
richard.evans@hsf.com

Introduction

In the **last edition**, we speculated about changes which might be announced in the Autumn Budget. We thought that a major overhaul of the pensions tax regime was unlikely, given that the Government's "landmark pensions review" was ongoing. But (we said) the Chancellor might well close a perceived loophole as to inheritance tax, by bringing any unused DC funds within the value of a member's estate.

We were half-right. The Budget did not see changes to pensions tax relief, or to the way in which pension provision is treated for national insurance purposes. However, the inheritance tax changes announced by Rachel Reeves do not just close the perceived loophole. They go much further: from 2027, almost all types of death benefit will count towards a member's estate. The potential impact is evident from the Government's own figures, which suggest that in due course the change could increase the annual tax take by £1.4bn.

What of the pensions review itself? Progress has been slower than planned, but an interim report on phase 1 (investment) was published in conjunction with the Chancellor's Mansion House speech. The over-arching theme is scale. Supersizing will, in the Government's view, drive productive investment, to the benefit of both members and UK plc. Hence proposals to accelerate the pooling of assets within the Local Government Pension Scheme, and to move towards a minimum size requirement for multi-employer DC arrangements.

No word, at present, on whether the Government will also scale up minimum contributions under the auto-enrolment regime. Expect this to feature in phase 2 of the review.

Quarter in review

Autumn Budget: death benefits and IHT

In her **Budget speech**, the Chancellor announced that the Government would bring most pension scheme death benefits into the inheritance tax (**IHT**) regime from April 2027. A **consultation** was published on the day of the speech.

As things stand, pension scheme death benefits are generally invisible for IHT purposes. DB dependants' pensions do not count towards a member's estate. Nor does a lump sum death benefit (**LSDB**), provided that the recipient is chosen by the trustees under a "discretionary trust" provision. Of course, that fact that death benefits are invisible for IHT purposes does not mean that the benefits themselves are tax-free.

The Government proposes that:

- DB dependants' pensions will continue to be invisible for IHT purposes. But, from April 2027, most other types of authorised death benefit will be deemed to form part of a member's estate. This principle applies to both DC and DB schemes, and to lump sums even where the recipient is chosen at trustees' discretion.
- The principle extends to defined benefit lump sum death benefits, such as might be payable on death-in-service. However, a note in the consultation paper states that "life policy products purchased with pension funds or alongside them as part of a package offered by an employer are not in scope". It is unclear whether this means that a lump sum will be out of scope if the trustees insure the benefit.
- Trustees will be required to report relevant death benefit payments to HMRC, and to pay any IHT attributable to those benefits. Trustees will need to liaise with a member's executors or administrators for this purpose. The consultation document explains the proposed mechanisms and deadlines.

The Government is not proposing changes to the tax treatment of benefits themselves.

The consultation closes on 22 January 2025.

Comment: The fact that a death benefit counts towards a member's estate does not, in itself, mean that IHT will be payable. In many cases no tax liability will arise, either because the estate is within the IHT "nil-rate band" (£325,000), or because of the IHT exemption for money which passes to spouses and civil partners. But where an in-scope death benefit is paid to someone other than a spouse or civil partner, and the estate, including the death benefit, is substantial, IHT may have to be paid.

The proposals will have significant implications – not only for trustees and members, but also for employers, who will want to ensure that death benefit provision is tax-efficient. Our **blog post** discusses the implications further.

Interim report on pensions review

In her **Mansion House speech**, the Chancellor announced the publication of an **interim report** on phase 1 of the Government's pensions review. Phase 1 focuses on investment. The interim report outlines the Government's thinking on four "workstreams":

- **Scale and consolidation in the DC workplace market**. Many DC schemes are not of sufficient scale, or are not making use of scale, to invest in productive assets and deliver optimal returns.
- **The Local Government Pension Scheme (LGPS)**. Steps previously taken to pool LGPS assets have delivered benefits in the form of scale, diversification and cost savings. However, progress and approaches have been inconsistent across the scheme.
- **Cost versus value in DC workplace schemes**. An excessive focus on keeping costs down has been counterproductive. Low investment budgets make it harder for schemes to invest in productive asset classes, with adverse implication both for members and for the UK economy. The proposed new value-for-money framework is intended to address this. However, there are concerns that the framework may not achieve the culture-shift required.
- **UK investment**. By increasing scale and improving governance, the Government can prime schemes for additional investment in productive asset classes. Separate initiatives will help ensure that there is a pipeline of suitable investment opportunities (eg the National Wealth Fund and the British Growth Partnership).

The Government proposes to address the concerns as to LGPS and the DC workplace market via the changes described below.

A final report on phase 1 will be published in spring 2025, together with terms of reference for phase 2.

Comment: The Government has for the time being decided not to make specific recommendations in relation to UK investment (LGPS aside). However, phase 2 of the pensions review will consider whether "further interventions" may be needed, to ensure that reforms are benefiting UK growth.

DC megafund proposals

The Government published a **consultation** on measures to drive the consolidation of DC schemes.

For multi-employer workplace DC schemes (master trusts and group personal pensions), radical changes are proposed. The Government plans to introduce maximum number and minimum size requirements for "default" investments. Current thinking is as follows:

- Schemes used for auto-enrolment will be required to have no more than a specified number of defaults. The idea is to limit the number of separate defaults which a provider can operate, to reduce fragmentation.
- Defaults will be required to be of at least a specified size. The idea is to prescribe a minimum level for assets under management (**AUM**).

- The requirements may apply either at "default arrangement" level, or at "default fund" level; the Government is as yet undecided. The distinction is important. A scheme's default arrangement might be relatively small but the underlying default funds (if used also by other schemes) might be substantial.
- The requirement will not apply before 2030 at the earliest. In the interim, providers might be required to formulate plans to achieve compliance by the implementation date. The Government recognises that some providers might be unable to achieve compliance, and so might be forced to consolidate.
- Further thought will have to be given to special cases – eg existing schemes where there may be public interest grounds for exemption; and possible new entrants to the market.

The Government plans also to introduce a bulk transfer power in relation to contract-based arrangements, so that members can be transferred out of an arrangement without the need for individual consents. The Government suggests that:

- The bulk transfer power could be used where a workplace arrangement has received a "red" rating under the proposed new value-for-money framework. The power would apply also to non-workplace arrangements.
- The provider would propose the receiving arrangement, which could be either contract-based or trust-based. A third-party expert (generally, the provider's independent governance committee) would decide whether, in the interests of members, the transfer should proceed.
- The FCA will make rules to provide safeguards and potential recourse for members. The FCA might be given powers to mandate transfers in certain circumstances.

The relevant primary legislation might be included in the forthcoming Pension Schemes Bill, depending on the outcome of the consultation.

Separately, the Government is concerned about the processes whereby employers choose workplace pension schemes. It will consider whether changes should be made, for example as to employers' duties or the provision of advice to employers.

The consultation closes on 16 January 2025.

Comment: A previous consultation on value-for-money suggested that there was significant support, within the pensions industry, for the introduction of a bulk transfer power. However, the "maximum number" and "minimum size" proposals will be controversial. The Government has not specified figures, but seems to have in mind a minimum size of £25-50bn. It is not yet clear whether or how the Government will accommodate niche players, non-commercial master trusts or new entrants to the market.

Changes to LGPS investment and governance

The Government launched a **consultation** about changes to investment and governance arrangements under the Local Government Pension Scheme.

LGPS comprises 86 separate funds, each managed by an administering authority (**AA**). Between them the funds hold assets of £400bn.

Successive Governments have sought to promote the pooling of assets for investment purposes. The 86 AAs have come together in groups of their own choosing so that there are now eight asset pools. 45% of LGPS assets are currently within the pools. A further 27% of assets are managed by the pools but sit outside them.

The Government proposes to accelerate pooling and promote productive investment, by making the following changes:

- **Reforming the asset pools**. The Government will mandate minimum standards. All pooling will have to be via authorised investment management companies (currently, three pools operate on a different model). AAs will have to take advice on investment strategy from, and delegate implementation to, the relevant pool. AAs will have to transfer legacy assets into (or into the management of) the pools.
- **Boosting investment in UK regions**. AAs will have to liaise with local and regional authorities, and take account of local growth plans. AAs will have to state their policy on local investment (including a target allocation), and report on investments actually made. Pools will have to conduct due diligence on proposed local investments, and will make the final decision on whether to proceed.
- **Strengthening governance**. AAs will have to publish various governance documents, and to appoint a named officer with pension responsibility. AAs' pension committee members will be required to have appropriate knowledge and skills. Pool boards will have to include representatives of AAs and improve transparency.

The reform of asset pools will be implemented through provisions in the forthcoming Pension Schemes Bill, probably with effect from March 2026. The other changes will be introduced via Regulations and guidance.

The consultation closes on 16 January 2025.

Comment: Changes to accelerate pooling are no surprise. The direction of travel is much as signalled by the Conservative Chancellor in year's Mansion House speech.

The significance of the associated governance proposals should not be underestimated. There will be real challenges for AAs and pools in aligning themselves with the new regime.

Proposals to allow multi-employer CDC

The Government published a **consultation** on proposals to extend the statutory regime for collective defined contribution (**CDC**) schemes, so as to allow multi-employer CDC schemes.

CDC is a halfway house between DB and DC. The contributions of members and employers are fixed, as with DC, but assets are invested collectively and mortality risk is pooled. CDC schemes seek to deliver a DB-like target benefit (eg 1/80ths of average earnings), but the benefits actually paid are adjusted if necessary so as to keep funding in balance.

CDC schemes are not subject to the DB funding regime or the employer debt legislation. Nor do they qualify for PPF protection.

The statutory regime for CDC schemes was provided for in the Pension Schemes Act 2021. Under the regime:

- As things stand, a CDC scheme must be for a single employer or a group of connected employers.
- CDC schemes are subject to authorisation and supervision by The Pensions Regulator.
- There are special rules as to the governance and operation of CDC schemes.

Under the Government's proposals:

- A new type of CDC scheme will be permitted: a scheme for two or more unconnected employers (a **multi-employer scheme**).
- The regime will be modified in various ways for multi-employer schemes. The modifications reflect the fact that multi-employer schemes are likely to be set up by commercial providers, and will need to cater for diverse employers and workforces.

The consultation closed on 19 November 2024. The Government proposes to implement the changes via Regulations (a draft has been published). The Regulations will be laid in 2025. A consultation response will be issued at the same time.

Comment: The consultation came just as the UK's first and only CDC scheme was launched: the **Royal Mail Collective Pension Plan**.

Royal Mail is an unusual employer, with a large (100,000) and unionised workforce. The appetite for CDC among employers generally has yet to be tested.

Note that the changes will allow "whole life" multi-employer CDC schemes. The Government does not at this stage propose to allow "decumulation-only" CDC.

New DB funding regime – nearly there...

The **DB Funding Code of Practice**, discussed in previous editions of the Pensions Planner, came into force on 12 November 2024. The Code applies to valuations under the new funding regime – those where the effective date is on or after 22 September 2024.

The Pensions Regulator published an **interim response** to its consultation on statements of strategy under the new regime, and illustrative templates. The interim response outlines changes which the Regulator has made in the light of the consultation, mostly to allow a simpler and more pragmatic approach. The Regulator will publish a fuller consultation response in the course of the winter.

The Regulator also published a **summary** of the parameters for the "fast track" option, under its new twin-track regulatory approach.

Comment: Some loose ends remain. The Regulator has not yet published covenant guidance for the purpose of the new regime. And, whilst the industry now has illustrative templates, statements of strategy must be submitted online, via a new digital service. The service will not be up-and-running until spring 2025, at which stage the format of the templates is likely to change.

Tax on refunds: HMRC "clarification".

An HMRC **newsletter** included a brief item about how tax is calculated where a refund of surplus is paid to an employer. The newsletter states that the tax is based on the gross amount of the surplus payment, not the amount which the employer actually receives. HMRC will update the Pensions Tax Manual in due course to reflect this.

Comment: There has been debate within the pensions industry about how tax on refunds should be calculated. The newsletter is presumably intended to close down the debate. The approach specified in the newsletter ("gross amount") results in a higher tax payment than the alternative ("amount received").

HMRC does not of course have power to determine what the relevant legislation actually requires; that is a matter for the courts.

Court fixes problems with scheme documentation

A High Court **judgment** addressed various issues as to the governing documents of a DB scheme.

In 2001 and on two occasions in 2005, the parties had purported to amend the scheme's rules via "scheme amendment authorities" (**SAAs**). Among other things, the SAAs had provided for changes to pension increases. In 2006 the parties had adopted a new set of rules (the **2006 Rules**).

Under the scheme's amendment power, any amendment had to be declared in writing and signed by all trustees.

Three potential problems were later identified:

- **A fully-signed version of the 2001 SAA could not be found, though there were two different part-signed versions**. The Court said that secondary evidence can be used to prove the existence of documents. Based on witness testimony and the way in which the scheme had been administered, it was clear that all of the trustees must have signed the 2001 SAA. Against that background, the Court found, as a fact, that the later of the two extant versions had been signed by all trustees.
- **On the face of it, one of the trustees had not signed the SAAs in his trustee capacity**. A Mr Beauchamp had signed against a signature block stating the signature to be on behalf of the employer. However, there was compelling evidence that Mr Beauchamp had intended to sign also as a trustee. On that basis, the Court ordered rectification of the signature blocks, to confirm that Mr Beauchamp had signed in both capacities.
- **The 2006 Rules did not reflect a change to pension increases made by a 2005 SAA**. The Court concluded that this was simply a mistake. There was nothing which suggested that the parties had intended to reverse the change to pension increases (eg no actuarial advice had been obtained). Accordingly the Court ordered rectification of the 2006 Rules to reflect the change.

Comment: Missing documents are not unusual. Trustees and employers will be encouraged by the Court's willingness to assume that the 2001 SAA had been signed by all relevant individuals, even though a copy could not be found.

What of Mr Beauchamp? Defective execution will often mean that a document is invalid. The judge adopted a creative solution, suggested during the course of the trial. This seems to be the first case in which the courts have ordered rectification of a signature block rather than a document's operative provisions.

Ombudsman awards £10m against trustee director in scam case

The Pensions Ombudsman **determined** that a corporate trustee (**ETL**) breached its duties under two money purchase schemes (the **Schemes**). He ordered ETL's former sole shareholder and director, Mr Shroff, to pay a total of £9.8m.

About 200 people had taken transfers from previous pension arrangements to the Schemes. ETL had invested Scheme assets in arrangements which were unorthodox and highly risky. The investments failed and, following an investigation by the Insolvency Service, ETL was wound up.

Several members of the Schemes complained to the Ombudsman. A complaint was also made by the replacement trustee.

The Ombudsman concluded as follows:

- ETL had failed to comply with requirements of the Pensions Act 1995 as to investment (eg requirements about obtaining advice and ensuring diversification).
- ETL had failed to comply with its fiduciary duty to invest for a proper purpose, ie in members' long-term interests.
- ETL had failed to comply with the requirement of the Pensions Act 2004 as to internal controls. This conclusion was informed by the fact that ETL had not followed various provisions of the Regulator's relevant Code of Practice (eg provisions about conflicts of interest).
- Although not himself a trustee, Mr Shroff had dishonestly assisted in the application of the Schemes' assets. He was therefore liable as an accessory to ETL's breach of trust.
- Mr Shroff was in any case liable on other bases. Having procured the breaches of trust by ETL, he was liable as a "constructive trustee". He was also liable as a "manager" and "administrator" of the Schemes. The Ombudsman's jurisdiction extends to people acting in those capacities.
- Members could not be said to have consented to the breaches committed by ETL. They might have chosen particular investments, but they did not know the full terms and circumstances. Given the nature of the breaches, neither ETL nor Mr Shroff could rely on a defence of contributory negligence.
- ETL was not protected by exoneration clauses in the Schemes' documents, or by indemnity forms which members had signed. The Pensions Act 1995 prevents trustees from excluding liability for breach of their investment duties.
- Mr Shroff should pay £7.3m into one of the Schemes and £2.5m into the other. He should also pay £5,000 to each of the complainant members, as compensation for exceptional non-financial loss.

Comment: This was a substantial determination – 140 pages. It lays down a marker as to the approach which the Ombudsman will take in other similar cases.

Personal liability is rarely an issue for trustee directors; as the Ombudsman acknowledged, they are normally protected by the "corporate veil". But that does not mean that a director can escape responsibility for deliberate wrongdoing.

As the pensions industry get to grips with the Regulator's new General Code, the determination illustrates a point often made: Codes might not be legally binding, but trustees who fail to follow them may be deemed to have breached statutory obligations.

Ombudsman to roll out expedited determinations

The Pensions Ombudsman published an **update** about the new operating model discussed in our Autumn Pensions Planner.

The Ombudsman has been piloting expedited decision-making in cases where the answer is felt to be clear. Under the expedited process, a caseworker will issue an initial decision. If any party does not accept the decision, they may ask for the matter to be referred to the Ombudsman, who will issue a final determination if he agrees with the caseworker's view. The expedited process is typically 18 months quicker than a full adjudication.

The pilot has been a success, so the expedited process will be rolled out.

Comment: Separately the Ombudsman has said that he may publish factsheets about common legal issues, to facilitate the resolution of complaints via schemes' dispute resolution procedures.

Other news

Other developments over the quarter included the following.

- **LTA abolition**. A **second** and **third** set of amending Regulations were made as to abolition of the lifetime allowance. Among other things, the Regulations address problems which had been identified for people with LTA protections and lump sum protection.
- **Changes for overseas schemes and transfers**. As part of the Autumn Budget, the Government **announced** an immediate change to the tax rules for overseas transfers, and future changes to rules for overseas schemes. These changes are provided for in the **Finance Bill 2024-25**. There are no other pensions provisions in the Bill.

- **PPF levy**. The Pension Protection Fund **consulted** about levy proposals for 2025/26. The PPF proposes an overall target of £100m (the same as for 2024/25), with minor changes to the rules about how liability is distributed.
- **PPF assessment valuations**. Following a consultation discussed in a previous Pensions Planner, the Pension Protection Fund **confirmed** that it will allow more flexibility as to the basis on which small schemes are valued when in PPF assessment. The change takes effect retrospectively from 31 May 2024.
- **Creditors' recourse to pensions**. The Court of Appeal **held** that a member could not be ordered to draw down funds under an occupational pension scheme so as to pay amounts owed to a creditor. Such an order would be inconsistent with section 91 of the Pensions Act 1995, which was designed to protect pension rights from creditors.
- **Dashboards**. The Pensions Dashboards Programme published **updated drafts** of its standards and code of connection.

Timeline

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

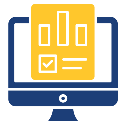
These are the expected connection dates specified in the DWP's staged timetable. The applicable date depends on a scheme's size and type

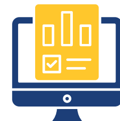
31 October 2026
Longstop date for dashboards

This is the mandatory deadline for connection

2026-2028
State Pension Age

Increases to 67



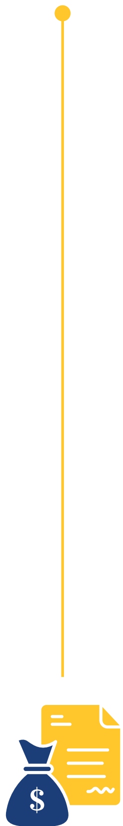


2025

2026

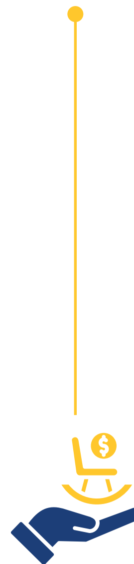
April 2027
Death benefits and inheritance tax

Proposed date for changes to the IHT regime



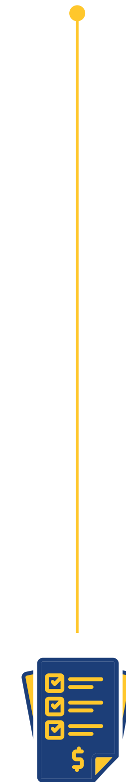
6 April 2028
Increase in normal minimum pension age

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



2027

2028

2030

In the pipeline

The next six months

Pensions review and Pension Schemes Bill

Th Government will publish a final report on phase 1 of the pensions review in spring 2025, together with terms of reference for phase 2.

Publication of the Pension Schemes Bill is likely to follow. The King's Speech indicated that the Bill would cover commercial superfunds, small pot consolidation, DC decumulation, and the extension of any new value-for-money framework to trust-based schemes. From the Mansion House speech, it seems the Bill will go further, covering changes to the Local Government Pension Scheme, and perhaps also "maximum number" and "minimum size" requirements for workplace DC arrangements.

Scheme funding regime

We expect The Pensions Regulator to issue covenant guidance in spring 2025, and to launch its online system for submissions under the new regime.

High Court hearing on validity of amendments

A case on the validity of past amendments to TPT, an industry-wide pension scheme, is listed for Q1 2025. We understand that the Court will consider questions arising from the Virgin Media case.

VFM framework

The industry awaits the outcome of the FCA's consultation on its proposed new value-for-money framework, which closed on 17 October 2024. The proposals (including a "traffic lights" rating system) met with significant pushback. It may be some time before a consultation response emerges.

Notes

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