Sackers

Quarterly briefing

September 2024

Highlighting significant developments in pensions law, covering key areas such as pensions reform, regulatory developments, new legislation and cases

Q3
September 2024

On the front cover this quarter:
Helen Ball (partner) and
Ian Cormican (partner)

Abbreviations

A-Day: 6 April 2006
DB: Defined benefit
DC: Defined contribution
DWP: Department for Work and Pensions
EP: Enhanced protection
F&I Strategy: Funding and investment strategy
FAS: Financial Assistance Scheme
FCA: Financial Conduct Authority
HMRC: HM Revenue & Customs
HMT: HM Treasury
LDIA: Low dependency investment allocation
LGPS: Local Government Pension Scheme
LSA: Lump sum allowance
LSDBA: Lump sum and death benefit allowance
LTA: Lifetime allowance
LTA-Day: 6 April 2024
PCLS: Pension commencement lump sum
PP: Primary protection
PPF: Pension Protection Fund
PRs: Personal representatives
TPO: The Pensions Ombudsman
TPR: The Pensions Regulator
TTFAC: Transitional tax-free amount certificate
UFPLS: Uncrystallised funds pension lump sum
VFM: Value for money

In this issue

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Current legal agenda

Topic	Summary	Timing
DB scheme funding	TPR's final draft DB funding code laid before Parliament	Once in force, the code will apply to valuations with effective dates on or after 22 September 2024 (see pages 4 & 5)
Removing the LTA	LTA removed from 6 April 2024	Further updates to the legislation are expected (see page 6)
Pensions Dashboards	Schemes must take into account the staging timetable in DWP connection guidance. Our recent survey reveals some challenges schemes are facing	Ultimate statutory connection deadline is 31 October 2026, but phased scheme connection set by DWP guidance starts from 30 April 2025[1] (see pages 7 & 8)
Pension Schemes Bill	Government plans to bring forward a range of measures, including decumulation duties for DC schemes and legislating for commercial DB superfunds	Pension Schemes Bill expected during this Parliamentary session, but no indication yet on the timing of new measures (see page 9)
Government's pensions review	Review of the pensions landscape launched to "boost investment, increase pension pots and tackle waste"	First phase, focusing on investment, expected to report in the next few months (see page 10)
VFM	FCA's recent consultation marks the first step towards a new market-wide VFM framework for DC schemes.[2] VFM changes for DC trust-based schemes to be included in the Pension Schemes Bill	FCA's consultation closes on 17 October 2024, but the new framework's timing is currently unclear
Pensions transfers	Possible changes to the incentives and overseas investment flags following the DWP's review of the transfer conditions	Amending regulations expected
Notifiable events[3]	Consultation on changes to the regime back in 2021. Response to consultation and final regulations are outstanding	Unknown

1 See page 4 of our: Quarterly Briefing (June 2024)
2 See our Alert: FCA consults on the new value for money framework (8 August 2024)
3 See our Hot Topic: New reporting requirements (January 2022)

The new scheme funding regime

New DB funding regime

In future, DB schemes will be required to produce an F&I Strategy aimed at achieving “low dependency” on their sponsoring employer by the time they are “significantly mature”. Final regulations are already in place[4] setting out the framework for the new regime and, after months of speculation, the draft DB funding code was finally laid before Parliament on 29 July.[5] Alongside the code, TPR also published responses to its consultations on the new Code and its twin-track regulatory approach.

Applies to actuarial valuations with effective dates on or after 22 September 2024

With the draft code needing to be before Parliament for 40 days, there will be a gap between the new scheme funding regime starting and the code coming into force “in the autumn”. Schemes with effective valuation dates falling during this interim period will still need to comply with the new regime, as the legislation is already in force. In the unlikely event the code is changed, TPR will take this into account when assessing valuations.

The code – what’s new?

Against the backdrop of the then Government’s Mansion House reforms, the DWP revised the final DB funding regulations so as to better reflect flexibilities within the existing regime. Those flexibilities are now mirrored by the code, alongside other changes to key issues, including:

Stability in long-term planning

Following concerns that the proposed approach for determining scheme maturity was too sensitive to market movements, and would create difficulties for long-term planning, the regulations prescribe a fixed date (31 March 2023) on which economic assumptions used to calculate future maturity must be based.

In turn, TPR has revised its definition of “significant maturity”. It is now ten years for DB schemes and eight for schemes with cash balance benefits, with a “proxy” for smaller schemes adopting the Fast Track regulatory approach.

Impact on investment allocation

Final regulations helped allay concerns around trustee investment powers

In line with changes to the final regulations, the code is now clear that decisions in relation to the scheme’s actual investment allocation are not constrained by the notional investment allocation. This applies both at low dependency and along the journey plan.

That said, in most instances, TPR expects trustees to align their actual investment strategy with the F&I Strategy.

Replacing prescription with a principles-based approach

The definition of LDIA has been simplified to focus on being highly resilient to short-term adverse changes in market conditions. TPR has also removed prescription around evaluating the high resilience of a scheme’s LDIA, allowing trustees flexibility to carry out a test suitable for their scheme provided they are satisfied that it demonstrates low dependency on the employer.

In addition, a formulaic approach for determining the maximum level of risk that can be supported by the employer covenant has been replaced with a principle-based approach, recognising the different ways trustees assess risk and the support for this risk. Trustees will need to demonstrate that the covenant can support the risk being run during the “reliability period”. To help clarify what might be appropriate, TPR plans to confirm the test it will apply as an initial trigger for a regulatory risk assessment.

Open schemes

Open schemes can take new entrants and future accrual into account

Recognising their unique characteristics, the code offers greater differentiation between the way trustees intend to provide benefits (the long-term objective) and the requirement for trustees to set a journey plan to reach low dependency by significant maturity in the F&I Strategy. These

4 See our Alert: DWP publishes revised DB funding regulations (30 January 2024)

5 See our Alert: New DB funding code laid in Parliament (29 July 2024)

may not align for all open DB schemes, so trustees will be able to recognise that the scheme plans to remain open formally in their statement of strategy.

Assessing employer covenant
The code is clearer on how to assess the reliability and covenant longevity periods. TPR also sets out its expectations on how long these periods should be for a typical scheme, while acknowledging that some employers may be able to demonstrate a longer period.

Proportionality
Proportionality is a key code theme, with TPR setting out its expectations as to what it might mean in different scenarios. For example, the level of detail required to assess the employer covenant will depend on the size of the scheme relative to the covenant support, the scheme's funding position, the level of funding and investment risk, as well as scheme maturity.

TPR estimates that, as at March 2023, 62% of DB schemes fell within Fast Track parameters

New twin-track regulatory approach – a quick reminder

- **Fast Track** – acting as a filter for TPR, if a valuation submission meets a series of Fast Track parameters, TPR is unlikely to scrutinise it further and is less likely to engage with trustees. Fast Track is not risk-free, but rather it represents TPR's view of tolerated risk.
- **Bespoke** – trustees will have the flexibility to select scheme-specific funding solutions, so long as the funding approach and actuarial valuation meet legislative requirements and follow the principles of the final code. Circumstances in which trustees may follow the Bespoke route include where they wish to take more risk which is supportable by the employer covenant (and in line with scheme maturity) or where unique employer circumstances necessitate a different approach.

Essential guidance still awaited

What's still in the pipeline?

With just over a month to go before the new funding regime's launch, key pieces of the jigsaw have yet to slot into place, including:

- **TPR's regulatory approach** – additional details of TPR's twin-track approach, together with the filters it will use to identify which schemes' statements of strategy to look at in greater depth or trustees to engage with to understand their funding approach in more detail
- **final guidance on the statement of strategy**[6] – including proposed templates reflecting the different information that will be required depending on a DB scheme's circumstances, now likely "in the autumn"
- **updated covenant guidance** – a consultation focusing on the main areas that trustees must consider when assessing employer covenant will be published "in due course"
- **existing DB funding and investment-related guidance** – a review is expected to assess whether "any additional guidance is required to support trustees".

6 See our Alert: TPR consults on statement of strategy (5 March 2024)

Life after LTA-Day

Members with valid LTA protections retain rights to higher tax-free lump sums

The new regime

6 April 2024 marked the end of the LTA and the introduction in its place of two new personal tax-free lump sum allowances: the LSA (the standard amount being £268,275) and the LSDBA (the standard amount being £1,073,100). Like the LTA before them, they apply across all registered pension schemes.

An individual's maximum tax-free PCLS will be limited by their available LSA, as will tax-free elements of an UFPLS and standalone lump sums. In addition to the lump sums caught by the LSA, certain death benefits and other lump sums which are payable tax-free (eg a serious ill-health lump sum) will count towards the LSDBA.

New newsletter on the LTA's removal

HMRC's Newsletter 160 offers further guidance on the LTA's removal, including:

- a new online tool for members to check if they can apply for a TTFAC[7]
- a reminder of the information that schemes must include in a TTFAC, and
- information about payroll reporting for certain taxable lump sums.

Regulations designed to fix problems still pending

Further regulations expected

With the LTA's removal having proven complicated, regulations are expected to address (retrospectively from LTA-Day) "technical" errors and to tie up loose-ends which remain outstanding in the legislation, including:

- **Transferring to a new provider with EP** – currently, individuals with EP could lose their "permitted maximum" tax-free entitlement to certain benefits if they transfer their benefits, since the permitted maximum is calculated on a "per arrangement" basis
- **EP or PP with protected lump sum rights** – HMRC believes the legislation's current drafting may prevent EP or PP members with protected lump sum rights from taking a PCLS in excess of their usual protected LSA of £375,000
- **Scheme-specific tax-free cash** – correcting technical errors concerning calculating the level of protection, the effect of transfers, and reductions to the member's LSA
- **Lump sum death benefits paid from crystallised rights** – to prevent double counting, lump sum death benefits paid from funds which crystalised before LTA-Day will not reduce an individual's LSDBA. However, the tax-free amount of such benefits could be unintentionally limited.

Key takeaway

HMRC's Newsletter 158 suggested that affected members (or their PRs) may wish to delay[8] taking benefits or transferring to a new arrangement until the legislation is updated. With Newsletter 161 noting that a technical consultation on the draft legislation closes on 14 August, hopefully the regulations are not too far away now. But, given the lapse of time, trustees should take legal advice on making payments in the interim.

Statutory power to amend rules

Where schemes built the LTA into their benefit structure, certain time-limited transitional provisions may help prevent unintended consequences. However, there is no news yet on legislation to help schemes make rule changes, as there was when the new system of tax allowances first came into being at A-Day.

7 See our Hot Topic: Pensions tax – transitional tax-free amount certificates (July 2024)
8 See our Alert: LTA-Day – certain members may wish to consider delaying transfers or taking benefits (5 April 2024)

Pensions dashboards survey

We received 91 responses in total

Sackers dashboards survey

As part of our recent Quarterly webinar, we asked attendees to answer a couple of questions to help tease out key challenges in preparing for pensions dashboards, as well as the most likely follow-up queries schemes anticipate receiving as a result of member dashboards engagement.

Question 1:

What are you expecting to be the single biggest challenge for the pensions dashboards project?

Comments

Having previously asked this question back in 2022, the latest results indicate an interesting and significant shift in thinking in the intervening period. Back in 2022, providing accurate DB value data was the biggest concern for respondents by some margin at 40%, with data matching sitting at 19%. But matching overtaking DB value data probably reflects the fact that schemes' dashboards planning and preparation is now that much further advanced.

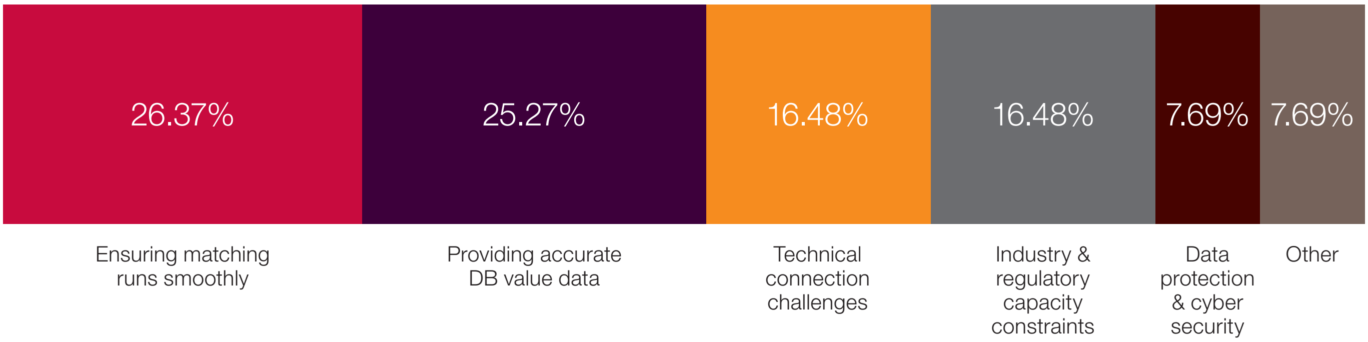
With the dashboards starting line edging closer, schemes should be limbering up

In line with the survey results, we are expecting the matching process to be one of the most challenging and complex aspects of dashboards. Schemes are likely to receive millions of "find" requests in the first months after launch, and must respond to each with confirmation of either a "positive match", "negative match" or a "partial match". Every "partial match" also has the potential to generate a manual workstream for administrators to resolve. Breaches can occur if schemes inadvertently get this process wrong.

Key takeaway

Legislation does not dictate what matching criteria should be, rather it is for trustees to decide their own matching policy and which data fields to use for matching purposes. Improving data quality and accuracy, as well as making important decisions about matching, are therefore top priorities for dashboards projects.

Expected single biggest challenge for your pensions dashboards project?



Question 2:

What do you think are the reasons members might contact a scheme's administrator having accessed pensions information on the dashboard?

Comments

With the results ranked in order, following up on a "partial match" was considered the most likely reason a member might contact a scheme's administrators. Again, this reinforces the benefit of improving data, if only by a small margin, to help minimise the number of "partial matches".

Requesting a transfer of benefits is also regarded as a probable reason for member contact, with dashboards poised to play an important role in addressing the existing proliferation of small DC pots and in accelerating consolidation. Differences in information provided, together with members being reminded about a pension, could also drive large volumes of traffic.

Schemes will be given at least six months' notice of dashboards going live

Key takeaway

Schemes should be talking to their administrators about how they plan to deal with inevitable increases in work volumes resulting from dashboards, as well as the impact on costs.

Most likely reasons for members getting in touch

1. Following up on a "partial match"
2. Querying differences between dashboards information & that received directly from the scheme
3. Raising some other queries, having been reminded about their pension with the scheme
4. Requesting a benefit transfer
5. Putting benefits into payment at the earliest opportunity

In other news

New Government, new appointments

Following the change in Government at the General Election on 4 July, Liz Kendall has been appointed as the new Secretary of State for Work and Pensions and Emma Reynolds as the new Pensions Minister. In a somewhat unusual move, Emma Reynolds has been appointed to serve as both Parliamentary Secretary and Under-Secretary at HMT and the DWP respectively.

Pension Schemes Bill announced in the King's Speech

Marking the State Opening of Parliament, the King's Speech took place on 17 July, focusing on growth and wealth creation. With DC trust-based schemes quoted as holding around £158 billion in assets across around 1,080 providers, and DB schemes as holding around £1.4 trillion in assets across approximately 5,000 schemes, the accompanying briefing papers recognise the significant role pension schemes play in the UK economy.

Labour's Manifesto promised to adopt reforms to ensure that workplace pension schemes take advantage of consolidation and scale, as well as delivering better returns for UK savers and greater productive investment for UK PLC. A new Pension Schemes Bill will therefore be introduced during this Parliament.

Pending legislation, trustees should follow TPO's guidance

In summary, the new Pension Schemes Bill will include measures to:

- ✓ prevent people from losing track of their deferred small DC pension pots, by automatically bringing them together in one place to maximise income in retirement and to help deliver value
- ✓ introduce a new standardised VFM test that trust-based DC schemes will need to meet to demonstrate they are delivering value. This is expected to apply consistently across the whole pensions market, with the FCA introducing rules for contract-based schemes
- ✓ impose new duties on trustees to offer a retirement income solution or range of solutions, including default investment options
- ✓ provide a legislative framework for commercial DB superfunds, with a TPR authorisation regime already in place
- ✓ reaffirm TPO as a "competent court", following the Court of Appeal's decision[9] that, where the recovery of an overpayment is disputed by a member, trustees must apply to the County Court to enforce a TPO determination
- ✓ change PPF and FAS compensation rules to enable lump sums to be paid to eligible members with a terminal illness at an earlier stage.

Comment

Although light on specific detail, many of the proposed reforms to be addressed by the new Pension Schemes Bill look set to build on at least some of the changes already in train.

9 See our case summary: The Pensions Ombudsman v CMG Pension Trustees Limited and CGI IT UK Limited (1 November 2023)

In other news cont.

Government launches pensions review

Following its Manifesto commitment to review the pensions landscape, the Government has announced the launch of a review to "boost investment, increase pension pots and tackle waste in the pensions system".

The first phase, led by the new Pensions Minister, Emma Reynolds, will focus on actions to support greater productive investment and better retirement outcomes, including through consolidation and "encouraging at-scale schemes to increase returns through broader investment strategies". This phase is expected to be reported on "in the next few months", and will also consider further measures to support the new Pension Schemes Bill.

New pensions review underway

The next phase, expected to start later this year, will look at additional "steps to improve pension outcomes and increase investment in UK markets, including assessing retirement adequacy". The review will also look at "how to unlock the investment potential" of the LGPS.

TPR updates DB superfunds guidance

Having revised its guidance just last year, further changes to TPR's DB superfunds guidance were expected to address how superfunds can extract profit.

Intended to support "innovation, while retaining protection for scheme members", the latest updates will allow capital to be released up to twice a year where a specific trigger and safeguards are met. The previous version of the guidance only allowed capital to be released when benefits were bought out.

In addition, standard capital adequacy requirements for a DB superfund may now be relaxed where a pension scheme's sponsoring employer becomes insolvent and the scheme is unable to afford the full buy-out of benefits. This is on the basis that other conditions are met, including that trustees are confident the transaction is in members' best interests.

Master trusts supervision

TPR has announced that it is "evolving" its supervision of master trusts to focus on investments, data quality and standards, as well as innovation at retirement. As part of its new approach, TPR expects to:

- probe and challenge more on how a master trust's approach to investments delivers for savers
- investigate how a master trust is seeking the best possible long-term risk-adjusted returns
- look more broadly at master trust investment governance practice and investment decision making, and
- request "deep dives" into the systems and processes of master trusts.

Cases

Virgin Media v NTL Pension Trustees II Limited (and others)

On 25 July, the Court of Appeal upheld the High Court's decision in the *Virgin Media* case[10].

Background

From 6 April 1997 until contracting-out on a DB basis ended on 6 April 2016, contracted-out schemes had to satisfy an overall quality test known as the "reference scheme test" in relation to contracted-out rights known as "section 9(2B) rights". The rules of contracted-out schemes could not be altered in relation to section 9(2B) rights unless:

- the trustees "informed the actuary in writing of the proposed alteration"
- the actuary "considered the proposed alteration" and "confirmed to the trustees in writing" that they were satisfied that the scheme would continue to meet the relevant statutory standard if the alteration were made ("Section 37 Confirmation"), and
- the alteration did not otherwise prevent the scheme from satisfying the requirements for a contracted-out scheme.

The Appeal

The case was determined on the assumption that a Section 37 Confirmation was not obtained in respect of a 1999 trust deed and rules. The appeal ultimately focused on a single limited issue: whether the words "section 9(2B) rights" and the requirement for an actuarial confirmation applied to both past and future service rights.

Changes made without the required Section 37 Confirmation are void

The Court of Appeal agreed with the High Court's "impressive judgment" that the legislation at the relevant time did not confine the requirement for a Section 37 Confirmation to amendments affecting past service benefits only. As such, relevant changes to both past and future service benefits would be void if the required confirmation was not given.

What does this mean for schemes that used to be contracted-out?

- Like the High Court judgment before it, overall, our view is that this latest decision doesn't expose pension schemes to any new risks.
- Importantly, because of the limited scope of the appeal, the type of evidence needed to demonstrate that a Section 37 Confirmation was in fact received was not explored.
- The legislation did not require a Section 37 Confirmation to be given in any particular form, so it could have been wrapped up as part of written advice given at the relevant time. As such, a deed making specific reference to a Section 37 Confirmation (or not as the case may be) will not necessarily be conclusive either way.
- Whether or not a Section 37 Confirmation was given is part of the wider question of whether all the necessary formalities (eg execution requirements, section 67 certificate) were satisfied when a scheme amendment was made. Whether trustees should take steps to investigate will depend, we think, on their scheme's specific circumstances.
- Given the potential for historical scheme amendments, including those beneficial to members, to be rendered void due to a lack of evidence of a Section 37 Confirmation, it is possible the DWP might exercise its power to make regulations to validate such changes.

10 See our Alert: Court of Appeal upholds High Court's Virgin Media decision on failure to obtain a s37 confirmation (26 July 2024)

Sackers

Upcoming webinars and seminars

We offer an extensive programme of client workshops and seminars. In addition to the quarterly legal updates, our seminars, which are led by our experts, offer clients the opportunity to ask questions and to share experiences on topics.

How to solve the problem of overpayments	11/09/2024	Online webinar In the complex world of pensions, mistakes happen, sometimes resulting in the overpayment of benefits. This session will offer practical tips and solutions to the difficulties and pitfalls that can arise.
New Trustee training	17/10/2024	In person seminar Our free and interactive seminar is a full day session, where we focus on the key legal issues for new trustees of DB, DC and hybrid schemes (as well as those who would like to refresh their knowledge).
Quarterly Legal Update webinar	14/11/2024	Online webinar This session will provide an essential overview of significant developments affecting occupational pension provision in the UK for employers and trustees.

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Recent publications

The Finance & investment briefing – September 2024 takes a look at current issues of interest to pension scheme investors.

Sacker & Partners LLP
20 Gresham Street
London EC2V 7JE
T +44 20 7329 6699
E enquiries@sackers.com
www.sackers.com