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PENSIONS ESSENTIALS

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INVESTMENT REVIEW AND REFORM OF THE DC MARKET

As part of its investment review, the Government has issued a consultation paper on reform of the DC market and "unlocking the UK pensions market for growth". The proposals focus on measures which are likely to lead to further consolidation of DC schemes.

In July, the Chancellor launched an investment review which focussed on four areas:

- driving scale and consolidation of DC schemes;
- tackling fragmentation and inefficiency in the Local Government Pension Scheme;
- the structure of the pensions ecosystem and achieving a greater focus on value; and
- encouraging further pension investment into UK assets to boost growth.

The Government has now issued an interim report on the review and two consultation papers, one looking at reform of the DC market and greater consolidation and the other looking at reforms to the structure, investment and governance in the Local Government Pension Scheme.

For the private sector, the most interesting proposals are in the DC consultation paper. In the foreword the pensions minister says: "*Whilst the UK pension market has been consolidating, the pace is too slow. I want to do more to facilitate and accelerate consolidation to ensure UK schemes have the scale to compete for investment opportunities with their international counterparts. This consultation includes proposals for further reforms, designed to ensure there are fewer, bigger, better run pension schemes with the resources to pursue the investment diversification that can deliver improved returns for hard working savers.*"

By way of evidence for the benefits of consolidation, the consultation paper says that it appears that the greatest economies of scale are available where a scheme has at least £10 billion of assets under management. In addition, much larger schemes are more likely to invest in infrastructure and other productive finance initiatives. However, the consultation paper offers little concrete evidence that bigger schemes deliver better value for members.

The consultation paper has a number of general proposals in it to further drive the consolidation agenda and generate larger investment funds, but it is short on detail. Some of the key points to note are:

- **Maximum number of default funds:** Multi-employer DC schemes used for auto-enrolment (which appear to be master trusts and group personal pension arrangements in the context of the consultation paper, but it is not entirely clear) could be required to have a maximum number of default funds. This is on the basis that larger default funds could allow for greater economies of scale and investment in a greater range of assets. The consultation paper also asks if there should be exceptions for specialist funds such as Sharia compliant funds. No proposed maximum number of funds is given, but evidence is quoted in relation to the Australian system where a single fund is required.

- **Minimum size default funds:** Multi-employer DC schemes should have a minimum size of default fund. The consultation seeks views on what the minimum size default fund should be. No figure is suggested, but the paper says: “Although there is no conclusive evidence of optimal size of [assets under management] at default fund level in DC pension schemes, a number of papers suggest a greater number of benefits can start to arise at £25 billion - £50 billion (or greater)”. Where the value of default funds falls below the minimum they will be given time to recover value.

- **Transfers without consent:** In relation to personal pension schemes, it is proposed that it will become possible to transfer members without consent in a number of circumstances, including where the existing arrangement does not provide value for money. Views are invited as to when such transfers should be permitted and what safeguards should be in place in relation to them. It is suggested that a scheme’s independent governance committee (or IGC) could be required to assess whether a transfer will be in a member’s best interests and could potentially incur liability if it is not and they were negligent in making the assessment.

- **Employer duties:** The paper considers whether greater duties should be imposed on employers to ensure that their pension arrangements remain appropriate for their workforce, but no clear proposals are made. Consideration is given to requiring employers to consider value for money and to have a member of staff responsible for pension outcomes.

- **Advisers:** Currently there is no specific regulatory regime regulating pension scheme selection advice services or investment consultancy services provided to employers (although such firms may be FCA authorised). The Government is asking for evidence on whether regulating scheme selection advice to employers would enable them to better consider overall value and whether regulating advice on investment strategies would enable more productive asset allocation.

Views are sought as to whether the proposals on minimum default fund size and maximum number of funds should operate at an individual default “fund” level or the default “arrangement” level, with the Government preferring the former approach. In either case, the Government recognises that this would be a significant change and will require sufficient lead-in time and so it is proposed that any default fund changes would not be applied until 2030 at the earliest.

In addition, because employers focus on price when selecting new pension arrangements, the Government asks whether it would be appropriate to remove the ability of providers to set differential pricing for the same pension product.

It is anticipated that these proposals would further consolidate the DC market into around 30 master trusts and 30 personal pension schemes. However, it is acknowledged that a more consolidated market might stifle competition and innovation and the consultation paper asks how this might be avoided.

More will be coming on assessing value for money (the third limb of the investment review) in the promised Pension Schemes Bill.

Practical points:

- *Watch out for more detailed proposals, although that may take some time.*
- *In the case of a smaller DC scheme, be aware of the continuing drive toward consolidation.*

RECTIFICATION FOR DEFECTIVE EXECUTION

In the recent case of Ballard v Buzzard where an individual had executed amending deeds on behalf of the principal employer and not also in his capacity as a trustee, the High Court rescued them by using its powers of rectification in a novel way. However, the judge did caution that this was an expensive solution to a problem that could have been avoided.

The courts have not always taken a pragmatic view to defective execution of scheme documentation. Most notably, in the case of *Briggs v Gleeds* in 2014 it was held that around 30 deeds, going back more than 20 years were invalid because signatures were not witnessed. These deeds included amendments to reduce the accrual rate and close the scheme.

However, a recent case may indicate that the courts are willing to be more practical. In *Ballard v Buzzard*, the court was asked to consider the validity of various deeds which reduced the increases payable on pensions in payment, closed the Scheme to new members, increased member contributions and changed the definition of pensionable earnings.

The evidence showed that the amendments in each of three deeds were adopted on the basis of actuarial advice and, following consultation between the employer and the trustees, it was their common intention to adopt these changes. However, under the rules of the Scheme, an amendment required all of the trustees "*to declare any such alteration or addition to the Rules in writing under their hands*".

The deeds had four signature blocks for the trustees (although there were five trustees) and one signature block for the employer. The signatory for the employer, Mr Beauchamp, was also the fifth trustee. The question arose whether Mr Beauchamp could be said to have executed the deed as a trustee when the execution block specifically said he was signing as an employer. There were also additional issues in relation to the first deed as no copy with all of the execution blocks signed could be found.

In relation to the capacity in which Mr Beauchamp executed the deeds, the execution clause was clear and a reasonable reader would have assumed that he was signing on behalf of the employer only. However, the judge thought that the evidence was overwhelmingly clear that Mr Beauchamp had intended to execute the document as a trustee as well. He took into account witness statements, trustee minutes agreeing to the amendments, the fact that Mr Beauchamp had circulated the deeds to the other trustees for execution, that he returned the deeds to L&G saying they had been "duly signed" by the trustees and the fact that the scheme had been administered on the basis that the deeds had been properly executed.

The judge thought that this was enough to satisfy the requirements for rectification and that the parties had a clear common intention which was not reflected in the final document because of a mistake. He, therefore, ordered rectification of the signature block to confirm that Mr Beauchamp signed in both his capacity as a trustee and for the employer.

The judge was also asked to consider whether the maxim that "equity regards as done that which ought to have been done" could apply but, as he had resolved the case by applying rectification, he did not have to reach a decision on that point.

This more practical approach to defective execution may be welcome to schemes who are questioning the validity of deeds following the Court of Appeal's decision in Virgin Media because actuarial confirmation cannot be found. It is hoped that when the High Court are asked to consider evidential questions around actuarial confirmations in February next year (in the case of *Verity v Wood*), a similarly pragmatic approach will be taken.

Practical points:

- *Note the importance of complying with all execution formalities in scheme documents.*
- *Be aware of differing approaches taken by the courts to defective execution.*

DB FUNDING REGIME

The Pensions Regulator's new funding code of practice came into force on 12 November 2024. It sits alongside the new funding regulations which set out long term funding and investment strategy requirements for valuations with effective dates on or after 22 September 2024. In addition, the Pensions Regulator has also issued the final version of the tests and conditions that must be satisfied for schemes that want to use a "fast track" approach to the new requirements.

Legislation in the Pension Schemes Act 2021 and accompanying regulations require trustees to have a funding and investment strategy which sets out the scheme's journey plan to full funding by the time it reaches a specified level of maturity (the "**relevant date**") and how reliance on the employer covenant will be reduced over time. These new requirements apply to valuations with effective dates on or after 22 September 2024.

Trustees also have to submit a statement to TPR setting out their funding and investment strategy. This statement must use one of four templates issued by TPR, depending on whether the scheme has used TPR's fast track approach and complies with prescribed risk parameters or a more bespoke approach and whether the scheme has reached its relevant date. Statements will need to be submitted via a digital platform which is not yet available and TPR has said that any scheme that misses the deadline to submit a statement because the platform is not available will not be treated as being in breach of the statutory requirements.

Where a scheme uses TPR's fast track approach, less information will be required in the strategy statement and TPR has said that it is "*unlikely to scrutinise it* further" and it is *"less likely"* that it will engage with trustees. TPR is clear that the fast track does not provide a risk free funding approach but rather intends to set out an approach to and level of risk that TPR thinks is appropriate. The fast track approach will not suit all schemes and does not represent a minimum level of compliance.

TPR has issued a document setting out the tests and conditions that a scheme must satisfy to use the fast track submission route. The fast track approach contains some relaxations for small schemes and very mature schemes, but generally the requirements will include:

- a minimum level of funding on the technical provisions basis, which will depend on how mature a scheme is;
- prescribed stress tests for different asset classes, liabilities and funding;
- recovery plans that are no longer than six years where a scheme has not reached its relevant date or three years where it has and which do not allow for future investment outperformance;
- assumptions which are at least as strong as those specified by the fast track. This includes assumptions in relation to the discount rate, inflation, commutation, mortality, survivors, discretionary benefits and salary increases; and
- an expenses reserve which relates to all non-investment related scheme expenses.

The scheme actuary will need to certify that a scheme meets all of the fast track parameters. If it does not, the trustees will need to submit a strategy statement using one of the bespoke templates.

Finally, the level of risk that can be taken in the funding and investment strategy depends in part on the strength of the employer covenant and we understand that TPR is still intending to issue more detailed guidance on covenant assessment in the near future.

Practical points:

- *DB trustees should be aware of the new funding and investment strategy requirements as they will apply to future valuations.*
- *Consider whether the fast track approach is appropriate for your scheme.*

REGULATING COLLECTIVE MONEY PURCHASE SCHEMES

Now the UK has its first collective money purchase scheme, the Pensions Regulator has issued a compliance and enforcement policy setting out its approach to regulating such schemes and how providers can expect it to supervise and engage with them.

The Royal Mail Collective Pension Plan launched on 7 October 2024 and became the UK's first collective money purchase or **"CDC"** scheme. The following day, the Government launched a consultation on expanding the availability of CDC schemes to allow unconnected multiple employer schemes (see the October edition of Pensions Essentials for more details). This will allow commercial providers to offer CDC schemes.

In CDC schemes, both employers and employees pay fixed DC type contributions, so there is no DB type funding risk for employers. However, unlike conventional DC schemes, members receive a pension directly from the fund. Schemes aim to provide a target pension but it is not guaranteed and can go down in payment if investments underperform so clear member communications are vital. There is no provision for member investment options and the fund is centrally managed. Investment and longevity risk are pooled.

Although there is currently only one CDC scheme, the Government is keen for the market to expand as such schemes potentially represent a better outcome for members than conventional DC schemes.

CDC schemes must be authorised by TPR and are subject to an ongoing supervisory regime. The authorisation and supervision regimes are similar to those that apply to master trusts, although there are differences to reflect the different benefits provided. TPR has issued a new compliance and enforcement policy which sets out how it intends to engage with CDC schemes and is aimed at both current and future schemes. It will be kept under review as the market develops.

TPR has powers to issue "risk notices" if it is concerned a CDC pension scheme is not being effectively run, governed or funded and is failing to satisfy the criteria for authorisation. TPR says that it will use risk notices "*where it wants to see trustees planning corrective action, which they must then deliver*". A risk notice can be used as an alternative to more serious powers, including de-authorisation. However, if trustees do not respond to it, de-authorisation remains an option.

TPR says that it will "*supervise CDC schemes in a collaborative and proportionate way. Its goal through supervision is to be clear on the outcomes [it] seeks for savers and to prevent compliance breaches or harms to savers before they occur*."

As part of its ongoing supervision of CDC schemes, TPR will send trustees an annual evaluation report summarising things such as the key risks it has observed, the actions it expects the scheme to take and its intended supervisory intensity.

Practical points:

- *Sponsors should consider if CDC might be an appropriate benefit for their workforce.*
- *Keep an eye on the emerging market.*

USING PENSION TO SATISFY JUDGMENT DEBT - EXTENT OF STATUTORY PROTECTIONS

The Court of Appeal has recently published a decision on the extent to which legislation protects pensions in occupational pension schemes from being used to satisfy a judgment debt against a member. The Court of Appeal overturned a decision of the High Court which had required a member to drawdown his pension to make it accessible to a creditor on the basis that legislation protects members' pensions in these circumstances.

Statutory protection is given to pensions payable from occupational pension schemes under section 91 Pensions Act 1995. This broadly provides that any attempt to assign, commute, surrender or exercise a lien, charge or right of set-off against such a pension will be unenforceable. In addition, a court cannot make an order restraining a person from receiving their pension. The rationale behind the protections was to ensure that pension assets could not generally be used for purposes other than those intended by the scheme. Furthermore, in most cases, scheme rules historically forfeited benefits when a claim was made against them by creditors or in the event of an attempted assignment.

There are exceptions to this wide statutory protection. In particular, the legislation permits pension benefits to be used to satisfy monetary obligations owed to an employer or to the scheme where the obligation has arisen as a result of the member's criminal, negligent or fraudulent act or omission, or if the member is also a trustee and owes money to the scheme, which has arisen from a breach of trust.

The extent of the protection offered by section 91 in relation to creditors seeking payment of a judgment debt was considered by the Court of Appeal in *Manolete v White*.

Mr White was the director of a company which had entered into a creditors' voluntary liquidation. Prior to this, Mr White had authorised a number of payments from the company for personal purposes for both himself and family members (including the purchase of two Bentleys, two Lamborghinis, a Porsche and foreign holidays in the Caribbean and the Maldives). There was no suggestion that any of these payments were made in the company's interests. The court found that the payments were made in breach of his fiduciary duties as a director and he was ordered to repay around £1 million. However, no payments were made by Mr White. Manolete, to whom the company's claims had been assigned, sought an order that Mr White should be required to drawdown monies from a small self-administered scheme on the basis that they could then be made available to it.

The High Court held that the court could require a debtor to exercise a power to call for payment of a pension. Section 91 was no obstacle to the court ordering a judgment debtor to access their pension pot as the member would still receive his pension, he would just be obliged to apply it in a particular way following receipt. The judge concluded that he could order the pension drawdown amount to be paid into a bank account in the name of Mr White and require him to provide Manolete with the details of the account on the basis that: "*It is neither just, nor convenient, nor equitable that [Mr White] should be entitled to retain his pension, derived entirely from moneys provided by the company, whilst the judgment debt entered against him… remains wholly unsatisfied*."

The Court of Appeal took a different approach and concluded that the intention behind section 91 was to ensure that "*a member's entitlement or right to future benefits under an occupational pension scheme should remain available to provide support to that member in retirement, so that, subject to specific exceptions… they should also be immune from attachment to pay the claims of creditors*".

Section 91 expressly prevents a court from making an order, the effect of which would be to restrain the member from receiving their pension. The Court of Appeal said that the policy intention meant that this should be read as "*receiving the pension for their own benefit*". The order that Manolete had asked the court to make "*formed part of a pre-planned sequence of steps that was designed to enable Manolete to enforce its Judgment Debt over the monies required to be drawn down from the Scheme and paid into the designated account. As such, the Order had the prohibited effect that Mr White would be prevented from receiving his future pension from the Scheme*."

As said above, there is an exception to the wide protection given by section 91 where set-*off is being exercised to allow an employer "to obtain the discharge by him of some monetary obligation due to the employer and arising out of a criminal, negligent or fraudulent act or omission by him*". The court did not have to decide whether breach of fiduciary duty came within these grounds as the issue was raised too late but did say that it was far from clear that breach of fiduciary duty owed to the company or "equitable fraud" of the kind alleged against Mr White was covered by the exception.

Although Mr White seems to have done rather well out of this judgment and possibly seems rather undeserving, the Court of Appeal said that the decision reflected "*the balance which Parliament has chosen to strike between the public policy of protecting… pensions from the claims of creditors, and the public policy of ensuring that judgment debts are paid*".

Practical points:

- *Be aware of the general protection offered to members under section 91 Pensions Act 1995.*
- *Note the Court of Appeal's approach to upholding that protection even where the member might appear undeserving.*

TAX UPDATE

The Finance Bill has been published which will implement proposals announced in the Budget relating to overseas transfers, overseas pension schemes and scheme administrators. Budget resolutions make some of these changes effective from 30 October 2024. However, there is no draft legislation and no more clarity around the imposition of inheritance tax on some benefits payable when a member has died.

The Finance Bill and budget resolutions set out changes in relation to transfers to overseas pension schemes and the tax position on such transfers. If an individual wants to transfer benefits from a registered pension scheme to an overseas pension scheme, there is a tax charge of 25% (the overseas transfer charge or "**OTC**") on the amount transferred unless one of a number of conditions is satisfied. Prior to 30 October 2024, these conditions included the member being resident in the same country as the receiving scheme or the receiving scheme being established in Gibraltar or a country within the European Economic Area (**"EEA"**) and the member being resident in the UK or a country within the EEA. With effect from 30 October, the second condition has been removed.

Where a member requested a transfer to a scheme in the EEA or Gibraltar before 30 October 2024, the exception from the OTC can still be applied as long as the transfer is completed before 30 April 2025. HMRC has provided guidance as to what they would consider to be a transfer request in these circumstances.

In addition, the Finance Bill amends the definition of overseas pension schemes and recognised overseas pension schemes, bringing the treatment of schemes established in the EEA in line with schemes established elsewhere in the world. These changes come into effect from 6 April 2025.

The Bill also makes changes to who can be a scheme administrator. For tax purposes, the scheme administrator is the entity responsible for complying with various obligations under the Finance Act 2004 and, in an occupational pension scheme, is usually the trustees. Currently, scheme administrators can be resident in the UK or an EU or EEA member state but from 6 April 2026, they will need to be UK resident.

In relation to the proposed IHT changes (see the October edition of Pensions Essentials for more detail), HMRC confirmed in a recent newsletter that "*unused pension funds and death benefits payable from a pension will form part of a person's estate for Inheritance Tax (IHT) purposes from 6 April 2027. As part of this change, the government proposes that pension scheme administrators will become liable for reporting and paying any IHT due on unused pension funds and death benefits*" and a technical consultation has been issued on the process and reporting requirements. No more detail has been forthcoming on exactly what benefits IHT is intended to apply to and, as the change is not due to be made for at least two years, it may be some time before we have any much needed clarification.

HMRC's newsletter also addresses speculation about the content of budgets which leads to members taking precipitate action based on what they think might happen, saying that such speculation "*can result in… companies marketing schemes that claim to allow individuals early access to their pensions to reduce their tax bill, or to reduce their exposure to changes that may come at a budget*" and that it would be grateful if schemes "*can remind… members that early access to pensions is rarely in anyone's long-term financial interests and can carry tax charges…*"

Practical points:

- *Watch out for further developments in relation to IHT on a member's death.*
- *Consider whether any of the other changes require changes to scheme administration.*

WATCH LIST

For upcoming developments see our pensions horizon scanning webpage.

No	Topic	Effective date or expected effective date	Further information/action
1	Changes to DC scheme governance and disclosure	2024/25	Anticipated that wording for new value for money framework in occupational pension schemes will be included in a new Pension Schemes Bill. The FCA has consulted on the requirements for personal pension schemes. Draft legislation on consolidating small DC deferred pots also expected in the Bill, along with new obligations in relation to decumulation options.
2	DB consolidation	2024/25 Public consolidator to be established by 2026, consultation on features closed on 19 April 2024.	TPR further updated interim superfund guidance - issued July 2024. Draft legislation on superfunds expected in Pension Schemes Bill.
3	Changes to pensions tax allowances	Lifetime allowance removed on 6 April 2024 and two new tax-free cash allowances introduced.	Further amending regulations came into force in November 2024, with effect from 6 April 2024.
4	Repayment of surplus	The reduction in the tax charge took effect on 6 April 2024. Consultation closed on 19 April 2024.	Tax charge on repaying surplus reduced from 35% to 25%. Consultation has closed on facilitating repayment of surplus in ongoing schemes. There is no reference to legislation being included in any forthcoming Bill.
5	Funding and investment strategy requirements for DB schemes	Legislation came into force 6 April 2024. Funding and investment strategy in place 15 months from date of the first valuation obtained on or after 22 September 2024. Revised Code of Practice from TPR came into force on 12 November 2024.	Consultation on covenant guidance expected late 2024/early 2025. The first strategy statements will need to be submitted electronically in spring 2025.

No	Topic	Effective date or expected effective date	Further information/action
6	Notifiable events for DB schemes on corporate and financing activity	Significant uncertainty about publication of government response to consultation on draft Notifiable Events (Amendment) Regulations. No dates are known as to when any progress will be made.	TPR will consult on update to Code of Practice 2 (Notifiable Events) and accompanying guidance once DWP have published their finalised regulations and consultation response.
7	Pensions dashboards	Compulsory connection deadline of 31 October 2026 for schemes with 100 or more active and/or deferred members at year end between 1 April 2023 and 31 March 2024; staging timetable set out in DWP guidance.	All registrable UK-based schemes with active and/or deferred members.
8	Collective defined contribution schemes	Legislation allowing unconnected multi-employer schemes may be issued in 2025.	The Government has consulted on the possibility of extending the legislation allowed collective defined contribution schemes to schemes for unconnected-employers, paving the way for commercial providers to offer such schemes.
9	DC consolidation	Proposals on default funds may come into force in 2030.	The Government has consulted on requiring multi-employer DC schemes to have a maximum number of default funds of a minimum size.

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